February 23, 2018

The Honorable Kamala Harris
U.S. Senate
112 Hart Senate Office Building
Washington, DC 20510

Dear Sen. Harris:

On behalf of the National Council of Higher Education Resources (NCHER), I am writing in response to the January 23, 2018 letter to Secretary of Education Betsy DeVos and Federal Student Aid (FSA) Chief Strategy and Transformation Officer Wayne Johnson in which you express concerns with the U.S. Department of Education's use of private collection agencies (PCAs) to collect defaulted federal student loans. NCHER and its membership are troubled by the letter because it portrays an inaccurate picture of the role of PCAs in the federal student loan programs. While we will leave it to the Department to respond to the specific questions, we hope that the following background will begin to answer some of your questions on the important services that PCAs provide to student and parent borrowers and to federal taxpayers.

According to the U.S. Department of Education, more than 43 million Americans collectively owe nearly $1.37 trillion in federal student loan debt. Of that amount, nearly $152.2 billion, owed by 9.07 million borrowers, is in default. While a relatively small number of borrowers (less than 1 percent) have student loans over $100,000, the average debt for those receiving a bachelor's degree is approximately $30,000, an amount that has risen at more than twice the rate of inflation over the last decade. With college costs and student loan debt on the rise, more borrowers are struggling to repay their federal student loans on time. At the same time, the federal government invests almost $100 billion each year in low-interest loans to college students with no collateral or proven ability to repay. This vital investment encourages a well-educated populace and benefits society as a whole. With it, however, comes a tremendous responsibility to ensure that these loans are repaid so that future students have access to the same opportunities as those who came before them.

For more than 30 years, the federal government has used private collection agencies to assist student and parent borrowers who have defaulted on their student loans to resolve their higher education debt, whether through repayment, rehabilitation, consolidation, or discharge and, by extension, to protect taxpayers' investment in the federal student loan programs. Borrowers and taxpayers alike benefit greatly from the work of these highly-specialized collection agencies that locate, communicate, and work with millions of students and families every year to make them aware of the many options that allow borrowers to get out from under the heavy burden of default. PCAs have been on the forefront of helping borrowers in default, including implementing new changes to the Loan Rehabilitation program begun in 2000 and new Income-Driven Repayment programs passed by Congress since 2007. But there's no doubt that more can - and must be - done. As Congress begins to reauthorize the Higher Education Act, NCHER and its PCAs strongly support efforts to allow defaulted borrowers to rehabilitate their loans more than once to address re-defaults, to provide comprehensive financial education to all students and families throughout the

student loan life-cycle, to protect vulnerable students from predatory third-party debt-relief companies, and other initiatives to help struggling borrowers.

Over the past 10 years, private collection agencies have helped over 2.6 million borrowers successfully rehabilitate their defaulted student loans, allowing each to improve their credit so that they have a chance to buy a house or car, or save for retirement. Over this same period, PCAs assisted nearly 1.1 million borrowers to pursue loan consolidation so they have an easier time in managing their student loan debt. In Fiscal Year 2017, private collection agencies were responsible for rehabilitating more than $49 billion in federal student loan debt, and recovered $10.6 billion in defaulted debt. The federal government keeps $10 of every $11 recovered by a PCA, showing the tremendous value of using private agencies in collecting federal debts. The return to the program is significant.

As detailed in this letter, debt collection is not easy work. Student loan borrowers are highly transient and challenging to locate; reaching and helping these borrowers requires a substantial investment in personnel and technology. The federal financial aid system is also overly complicated, offering nine different repayment options to help students manage their debt and, for defaulted borrowers, a loan rehabilitation program where borrowers can have their default record stricken from their credit report. FSA monitors the performance of PCAs using a number of metrics – including customer satisfaction – and the agencies are only paid if they are successful in locating borrowers and resolving their defaults. PCAs are not compensated for unsuccessful recoveries nor for the time, effort, and expense involved in these efforts, which must be factored into the compensation paid in those instances where the PCA is successful in helping the borrower. Contrary to reports in the media, borrower complaints – as a percentage of overall borrower contacts – are extremely minimal and PCAs work diligently to resolve each and every complaint. According to the latest FSA Feedback System Annual Report, just two percent of complaints are related to PCAs. Private collection agencies are among the most highly-regulated companies in business today. PCAs must comply with a multitude of federal and state consumer lending laws and regulations, including the Fair Debt Collection Practices Act, and are supervised by the U.S. Departments of Education and Justice, the Federal Trade Commission, and the Consumer Financial Protection Bureau. Oversight of these agencies is substantial and oftentimes overlapping, with the various federal and state agencies conducting numerous reviews and audits each year. PCAs under contract with the Department of Education make significant investments in information technology security to comply with the Federal Information Security Management Act (FISMA), are required to record 100 percent of all incoming and out-going telephone calls, employ only certified and trained staff, and provide for internal and external third party audits. All verbal and non-verbal complaints must be tracked and resolved as well.

NCHER hopes that this information will be helpful to you as you continue to examine the important role that private collection agencies play in the successful administration of the federal student loan program. We stand ready to serve as a resource for you. If you have any further questions, please feel free to reach out to me at jbergeron@ncher.us or (202) 822-2106.

Sincerely,

James P. Bergeron
President

cc: Signatories to the January 23, 2018 Letter to the U.S. Department of Education
Dr. Wayne Johnson, Chief Strategy and Transformation Officer, Federal Student Aid
Mr. James Manning, Chief Operating Officer, Federal Student Aid
Ms. Kathleen Smith, Deputy Chief Operating Officer, Federal Student Aid

Supplemental Information

Collection costs

Collection costs are neither determined nor added by the PCAs; they are assessed on federal student loan borrowers as required under the Higher Education Act of 1965 and are added by FSA to a borrower's outstanding principal and interest when the loan is placed with a PCA for resolution. FSA does not assess collection costs in all circumstances (e.g. charges are not assessed when a borrower completes the loan rehabilitation process). When assessed, borrower payments are applied first to collection costs, second to the interest balance, and finally to the principal of the outstanding loan, as required by federal law. Payments to PCAs are paid from the proceeds of collections, ensuring that taxpayers do not have to bear the burden of the costs of collection. All PCA contracting activity is cost and budget neutral to the federal government and its taxpayers as authorized by Congress through the Debt Collection Improvement Act of 1996.

Compensation to private collection agencies

PCAs are paid for their services based on performance, or via contingency fee arrangements. If a PCA does not resolve a borrower's defaulted loan through payment or administrative, non-cash resolution, the PCA is not paid. These performance-based contracts are widely used across the public and private sectors. However, unlike many private sector contracts, the Department of Education pays PCAs to work with borrowers to resolve their problems if it is a non-cash resolution. For example, an agency may help a borrower get his or he loan discharged for having attended a fraudulent school or because they are permanently or totaled disabled. PCAs are paid varying contingency fees based on the type of resolution they effect for the borrower. These fee rates are set by FSA based on market-research that is completed prior to every collection contract procurement. Also, fees are reviewed and modified whenever there are changes made by Congress that impact how defaulted loans are serviced or collected.

The average cost of collection to the borrower is difficult to measure – and would be largely inaccurate - in the federal student loan program because there are several ways for borrowers to resolve their defaults. For example, the Department waives all collection costs once the borrower rehabilitates his or her loan — so no additional collection costs are assessed to the borrower. Under loan rehabilitation regulations, student and parent borrowers work with private collection agencies to agree on reasonable and affordable payment plans, often allowing borrowers to repay their loans based on their income. After making nine voluntary, on-time payments within 10 consecutive months, the defaulted loans are rehabilitated and borrowers regain eligibility for federal student aid, including grants and loans. Just as important, the default status is removed from the borrowers' credit reports and borrowers are no longer subject to wage garnishment or tax refund offset. In Fiscal Year 2017, PCAs were responsible for rehabilitating more than $49 billion in federal student loan debt. Loan rehabilitation is more beneficial to the borrower than loan consolidation because collection costs are not added to the borrower's loan balance. As noted below, loan consolidation also has fewer benefits when it comes to a borrower's credit profile compared to loan rehabilitation, since the default record remains on the borrower's credit report, continuing to damage his or her overall credit score.

The costs of collection operations performed by PCAs are extensive. PCAs invest heavily in information security required to meet all FISMA standards, regulatory compliance (including those required by the Department, such as call monitoring), and other standards and audits required to obtain an Authority to Operate (ATO). The Department does not compensate PCAs for any of the up-front investment costs, or the ongoing costs to support this infrastructure. The PCA only generates a return on its investment if it successfully resolves accounts in accordance with the Department's requirements, pursuant to a 290-page PCA Procedures Manual, which details the work required by PCAs. Moreover, during the time that

borrowers are making payments under loan rehabilitation, PCAs bear the expense associated with servicing those accounts, with minimal compensation. This is a cost burden irrespective of whether the borrower completes his or her payments for rehabilitation. The agencies are audited regularly, through actual call recordings with the borrowers and access to PCA computer systems, to ensure compliance with the program requirements and applicable federal law.

Comparing loan servicing to private collection agencies

FSA pays its pre-default servicers differently from its PCAs because the services required of each are so different. For example, a large percentage of a pre-default servicer's portfolio is in repayment and current, compared to a PCA's portfolio where, by definition, none of the loans are paying as agreed at the time of placement. For non-performing accounts, the pre-default servicer has worked the account for nearly a year before turning it over to a PCA. The PCA often has to perform extensive and expensive skip-tracing activities just to find the borrower before attempting contact. The following additional reasons illustrate why pre- and post-default servicing is not an appropriate comparison:

- Federal student loan servicers are paid for each and every loan that is referred to them by FSA, regardless of the outcome for the borrower. The fees are used to carry out the various services required by FSA, such as sending correspondence or handling in-bound or out-bound calls to borrowers. PCAs are not paid for every loan placement but only for those borrowers where there is a collection or an administration resolution such as successfully helping remove the loan from default or entering into repayment.
- Federal student loan servicers are paid for maintaining their computer systems and making programmatic modifications to their systems to meet changes in federal rules or regulations. PCAs are not paid for any modification to their system or maintenance of their systems when FSA makes rules or regulatory changes. PCAs bear these costs completely at no cost to FSA.

Benefits of loan rehabilitation versus loan consolidation

There are several long-term benefits to borrowers who use loan rehabilitation as compared to loan consolidation to remove their loans from default. The key benefits are listed below:

- When a borrower completes his or her eligibility requirements for loan rehabilitation, the collection costs on the loan are waived by FSA. However, in loan consolidation, collection costs are added to the principal and interest balance of the new loan forming a new, higher principal balance on which interest accrues for the borrower. Therefore, it is more expensive for borrowers to consolidate than to rehabilitate their loans.
- When a borrower rehabilitates his or her loan, FSA will delete the instance of default from the borrower's credit bureau report. This helps improve a borrower's credit score. However, under loan consolidation, the new loan is reported to the credit bureau but the older, defaulted loan is still shown on the credit bureau report for a period of seven years from the first missed payment, which negatively impacts the overall credit score of the borrower.
- Borrowers achieving loan rehabilitation have shown fiscal discipline by making nine on-time and voluntary payments on their loans. This makes them a better credit risk than borrowers who consolidate to get out of default without having to make even a single payment.

For many borrowers, loan rehabilitation is the best way for them to get a "fresh start" and is better than simply consolidating the defaulted loan, which can result in a substantial extension of the borrower's repayment period. There is no question that it is a little more expensive for the federal government, but collection agencies are paid more to rehabilitate a loan because it is a nearly year-long effort.

The following is a list of just some of the steps that a PCA needs to follow to help a borrower rehabilitate a defaulted loan (the requirements for the program and the steps required of the PCA to guide the borrower through it are set out in over 20 pages of detailed instructions provided by the Department):

- Determine if the loan is eligible for rehabilitation, including loan type, whether any "disqualifying conditions" exist, and whether the borrower is eligible to seek the benefits of the program.
- Provide to the borrower a detailed explanation of the rehabilitation program, its benefits, and requirements, so the borrower is able to make an educated decision as to whether to take advantage of the program. The explanation includes a discussion of how payment amounts are calculated and the required financial documentation; the need for a signed loan rehabilitation agreement; the minimum number and timing of each payment, including an explanation of what payments will "qualify" toward rehabilitation; and the impact of any then-pending administrative wage garnishment (including the potential suspension of an active garnishment).
- Calculate the amount of each qualifying payment, based first on the borrower's adjusted gross income, family size, and state of residence, supported by copies of the borrower's tax return or tax transcript. However, if the borrower indicates the amount so calculated is not affordable, the PCA instead must determine the appropriate payment amount based on the borrower's Financial Information Statement detailing income and expenses, which must be verified by the PCA. This regularly requires lengthy and frequent phone communication with the borrower to explain the requirements and to obtain the necessary information and the requisite supporting documentation.
- Prepare, send to the borrower, and secure the return of a signed Rehabilitation Agreement Letter, in the form provided by the Department (often requiring numerous phone calls to the borrower).
- Document the Department's system to reflect the borrower's rehabilitation payment schedule, monitor the borrower's required payment, make phone calls and send letters to remind the borrower of each upcoming payment, including additional contacts if it appears the borrower may be at risk of missing a required payment, and follow up to "cure" (where possible) any required payments that may have been returned as Non-Sufficient Funds or for other reasons.
- Prepare and submit to the Department a complete rehabilitation package (including all requisite documentation) for rehabilitation funding, as appropriate.

<u>Poor performance of borrowers who complete loan rehabilitation</u>

NCHER and its private collection agencies understand the concern that borrowers who complete loan rehabilitation may quickly become delinquent after being referred to their federal student loan servicers. However, the issue presented is systemic rather than being reflective of the quality of services provided by either the PCAs or the servicers. For the last few years, the NCHER membership has urged FSA to work diligently to create an electronic hand-off between its PCAs and the federal servicers so that there is no delay between the time a borrower completes loan rehabilitation and is transferred to his or her servicer. This process was not envisioned or completed when the federal government became the sole originator of federal student loans and the Department created new income-driven repayment plans. PCAs anticipate these re-defaults to be reduced greatly in the coming months as FSA creates the required conduits between the PCA and servicer systems.

<u>Past efforts by Treasury to collect on defaulted loans</u>

In early 2015, the U.S. Department of Treasury's Bureau of Fiscal Service (BFS) began a pilot program with FSA to allow Treasury to learn more about the way that the federal government collects on defaulted student loans. Under the pilot, BFS was randomly assigned 16,242 defaulted loans owed by 5,729 borrowers, which had been in default, on average, for six years. Fifty-seven percent of the accounts were previously assigned to the Department's PCAs. On July 1, 2016, BFS released a report on the first-year of its pilot program. The report included the following findings:

- Federal student loan borrowers are difficult to reach. Despite making 21,000 calls, borrowers answered less than 2 percent of the calls. Treasury fielded 3,900 calls initiated by borrowers and, in the first year, spoke to approximately one-third of the borrowers in its portfolio.
- The complexity of the repayment options impact the ability of borrowers to mitigate their defaults. Borrowers cannot resolve their loans on their own; speaking with a call center agent is critical to identifying and enrolling in a repayment option. Borrowers in default may be more willing to take action on their defaulted loans if they have clear information about the available options. The complexity of the program requires longer call times and post-call work.
- The report noted that a control group of borrowers with similar demographics and metrics were placed with the Department's PCAs and tracked for performance. The dollars collected by the PCA's were three times as high as that collected by Treasury, and total recoveries (which included payoff balances for rehabilitations and consolidations) for the PCAs were nearly ten times higher. The report noted that Treasury did not employ all tools available for collection and did not attempt to initiate administrative wage garnishment until late in the first year of the pilot.

Administrative wage garnishment

The letter seems to suggest that the federal government should make greater use of administrative wage garnishment (AWG). This is, by far, the worst outcome for borrowers and is not the answer to the long-term repayment of federal student loans. Wage garnishment requires a payment of 15 percent of the borrowers' disposable pay, more than the monthly payment for borrowers actively enrolled in loan rehabilitation. AWG also involves informing the borrower's employer that he or she has financial problems, which brings in a whole separate set of issues. Many borrowers would rather be terminated from their jobs than have their wages garnished because the law protects them from further garnishment for one year. Moreover, borrowers who quit their jobs to prevent garnishment suffer from significant disruption and require additional collection steps to locate them. Garnishment should only be used as a last resort. The Treasury Offset Program is also a one-time collection and only works if the borrower has a refund coming from the Internal Revenue Service (IRS).

The letter also requests information from FSA on how much it would collect from AWG and the Treasury Offset Program if the agency did not use private collection agencies. According to recent data, FSA only collects $600 million from the Treasury Offset Program against the total value of $100 billion referred to Treasury. Thus, only an extremely small percentage of borrowers are offset and, even then, the offset average amount of $1,750 is not enough to cover the amount of outstanding debt owed by the borrower.

Alignment of incentives for PCA performance

The letter states that PCAs are provided an incentive for poor performance that is not in the interest of borrowers. It states that FSA will pay a PCA to rehabilitate a very low balance account of $100 so that it can be paid $1,710. This is entirely inaccurate. In truth, PCAs are paid the lesser of $1,710 or the amount being rehabilitated. As noted previously, PCAs spend more than nine months assisting struggling borrowers in loan rehabilitation. According to information obtained by FSA through market research, it is estimated that the cost to the PCAs of completing a rehabilitation ranges from $1,640 to $2,360. As such, it is not cost effective for a PCA to work on a loan balance of $100. In fact, since 1996, FSA has used its write-off authority to write off loan balances with total principal and interest less than $300. Finally, it is disingenuous to criticize PCAs for getting paid a loan rehabilitation fee for collecting payments as low as $5 per month. The Obama Administration changed the previous rules both to allow such small payments and to pay PCAs a flat fee to acknowledge that, for loan rehabilitation, the federal government was paying for an important service to support struggling borrowers.

Treasury's debt collection program

The letter references the recently published report about the IRS' debt collection program, specifically stating that the program expenses were $20 million while PCAs only recovered $6.7 million. However, the following facts need to be considered: (1) 2017 was the start-up year of the program which required a larger investment to create a long-term successful program; (2) the recoveries to date do not include the thousands of taxpayers who have entered repayment arrangements that will pay out significant amounts over time and exceed the program start-up costs; and (3) significant amounts of the program start-up costs were incurred to minimize any consumer abrasion and develop a beneficial program for the IRS and consumers. To this last point, the IRS cautiously started the program in April 2017 with very small account placements to the PCAs (100 accounts per week per PCA). The IRS's entire focus in 2017 included ensuring high-quality taxpayer satisfaction with minimal to no complaints, that proper borrower protections and rights were in place, and that PCAs have a top-level security infrastructure that passes rigorous reviews.

Conclusion

Debt collection is essential to a viable federal student loan program, returning scarce resources to benefit future students and ensuring that the program is accountable to taxpayers. Private collection agencies help millions of borrowers and parents every year find the solution that best suits their individual needs so they can get out of default and on with their lives. The work of PCAs is more important than ever before, especially as the number of students defaulting on their student loans continues to rise every year. These agencies provide much needed accountability to the federal student aid program and are the taxpayer's last and best defense for recovery of defaulted loans. The Department of Education is wise to use private collection agencies to manage its defaulted loan portfolio – and should continue to improve its management of the program for the benefit of students, families, taxpayers, and the companies doing this important work.