THE PROJECT ON STUDENT DEBT

Testimony of

Lauren Asher
Associate Director, Project on Student Debt

Before the U.S. Department of Education, Office of Postsecondary Education

In Response to the October 22, 2007 Notice of Negotiated Rulemaking for Programs Authorized Under Title IV of the Higher Education Act of 1965, as Amended

San Diego, California
November 29, 2007

My name is Lauren Asher, and I am the associate director of the Project on Student Debt, an initiative of the Institute for College Access & Success, a nonpartisan, not-for-profit policy research organization. The Project's goal is to identify cost-effective policies that expand educational opportunity, protect family financial security, and advance economic competitiveness by reducing the burden of student debt.

Thank you for the opportunity to suggest issues that the negotiating committee(s) should consider in developing proposed regulations for the College Cost Reduction and Access Act of 2007 (CCRAA), Pub. L. 110-84. While the new law has many noteworthy provisions, my comments today focus on those directly concerned with student loan repayment and forgiveness. Our goal is to ensure that policies designed to make student loans more fair and manageable, and to encourage participation in higher education and public service, are as accessible and beneficial as possible to borrowers and their families. I am pleased to submit this testimony on behalf of America's past, present and future student loan borrowers.

Income Based Repayment

The new Income Based Repayment (IBR) program is modeled on a proposal developed by the Project on Student Debt with support from students, parents, lenders, and the higher education community. The purpose of IBR is to make sure student loan payments are fair and manageable, so that students who must borrow to afford a college education can invest in their own future – and the future of our nation – without risking financial ruin that can last a lifetime. If implemented with this goal in mind, IBR will encourage students of modest means to go to college, and ensure that responsible borrowers can eventually afford to start a family, save for retirement, and contribute to their own children's education. For IBR to fulfill its purpose and potential, it is particularly important that the negotiators address the following regulatory issues.

Maximum repayment period. The Secretary has the authority to set the maximum repayment period for IBR – the period after which remaining loan balances are canceled – as long as it does not exceed 25 years. We are asking the Secretary to set the maximum at *20 years*. A 20-year rule would reduce the risk that loan payments would permanently displace critical savings for retirement and children's education in households with little or no financial security. Moreover, after 20 years of qualifying payments any remaining balance would be only or mostly interest for the vast majority of borrowers.

In addition, and regardless of the length of the maximum repayment period, the rules should make clear that qualifying payments can accrue throughout the borrower's lifetime.

Qualifying payments. Borrowers in IBR are eligible to have their outstanding debt forgiven after making qualifying payments for a maximum period of time (see "Maximum Repayment Period" section above). The statute makes clear that all of the payments and periods described below are valid, in any combination, whether consecutive or not and whether they occurred before or after the law's enactment:[1]

- Payments made while in IBR;
- Payments made while in Income Contingent Repayment (ICR);
- Periods of economic hardship deferment (during which borrowers do not have to make any payment);
- Payments under a standard (10-year) repayment plan; and,
- Regardless of the repayment plan, payments that are at least equal to what they would have been under the standard repayment plan.

The rules must also be clear about the payments and periods that count toward the maximum repayment period. We support rules that make sure that borrowers who act in good faith are eligible for the benefits that IBR is supposed to provide. To that end, we suggest that qualifying payments include payments made under any payment plan that *equal or exceed what the borrower's payment would have been under either the IBR or ICR formula*, whichever results in a lower amount. Such qualifying payments would include a payment of "0" if that would have been the required payment in IBR or ICR. Payments that meet or exceed the amount that would have been required under IBR, ICR, or a standard repayment plan, but were made while the borrower was in forbearance, rehabilitation, or another repayment status would qualify as well.

Interest coverage. Under IBR, borrowers with low incomes relative to their debt levels may have required payments that are less than the interest charged for the period. The treatment of that interest varies by loan type and program. For subsidized Stafford loans, the IBR statute is clear that the government pays the interest for up to three years. The rules should clarify that these three years may occur at any point and not simply during the first three years of repayment.

Simple process for income confirmation. The process for determining IBR payments should be as easy for borrowers as possible. This same principle should also apply to other repayment

[1] The validity of periods prior to the law's passage is especially clear since the public service forgiveness provision explicitly limits that program to periods after October 1, 2007.

programs that consider the borrower's income, including ICR and economic hardship deferments.

To confirm their income for the purpose of setting affordable payments, the process for borrowers should be simple and straightforward. It should require no more information or effort than it takes to complete IRS Form 4506-T, a one-page form that allows any taxpayer to have their income data sent to any third party, private or public, including another government agency.[2] ICR participants currently use an even shorter form that the IRS has already approved, giving the IRS permission to provide the Department with required income data. This or a similar form should be extended to borrowers in IBR and accepted with the borrower's choice of either an electronic or hard signature.

The resulting process should eliminate the need for borrowers to produce and mail hard copies of tax forms and other documentation (with limited exceptions, including those described below), and reduce processing, storage and security burdens for both borrowers and the Department.

Alternative documentation for changed circumstances. IRS and other government records are not always up-to-date enough to provide a fair indication of a borrower's ability to repay. Borrowers should be able to provide alternative documentation of changed employment, changed family situations, and other factors that affect their income and required payment level.

Consistency between IBR and ICR

IBR and ICR share many goals and mechanisms, but there are differences in how they operate. This can lead to inequities and confusion for borrowers in similar circumstances. The Secretary has broad authority over the structure and application of ICR, and over several specific areas in IBR. We recommend that the new rules make these two programs more consistent in ways that do not disadvantage any borrowers, and that reduce administrative complexity and confusion. In particular:

Maximum repayment period. The Secretary has the authority to set the maximum repayment period for ICR, as long as it does not exceed 25 years. Consistent with the period suggested above for IBR, the maximum repayment period for ICR should also be 20 years, which can be accrued throughout the borrower's lifetime.

Rights for borrowers in default. Borrowers in default should have the same rights under both programs. Currently, borrowers can exit default by consolidating their loans in the Direct Loan program and then entering ICR to repay the consolidated loan. This provides a critical lifeline to borrowers who would otherwise find it difficult or impossible to ever rehabilitate their loans. Borrowers in default should have the same rights upon entering IBR, regardless of whether they consolidated their loans through the Direct or FFEL program.

Minimum payment. Under IBR, borrowers with incomes below a certain amount are not required to make any payment – the minimum payment is thus zero. The ICR regulations currently state

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[2] *Going to the Source: A Practical Way to Simplify the FAFSA,* the Institute for College Access & Success, 2007. Also see http://www.irs.gov/pub/irs-pdf/f4506t.pdf for the 4506-T form.

that if a borrower's ICR payment is more than zero but less than $5.00, then the required payment is $5.00. To reduce unnecessary paperwork for borrowers and the Department, the minimum payment in both IBR and ICR should be set so that calculated payments of less than $5.00 are rounded down to zero.

Interest capitalization. For unsubsidized loans (and for subsidized Stafford loans after borrowers have exhausted their three years of interest coverage described above), the IBR statute is clear that interest is charged but only capitalizes if and when a borrower exits IBR. It is clear that if a borrower's income increases, he can remain in IBR and make payments that do not exceed the original standard repayment amount, even though the loan balance may have increased due to added interest when his income was lower.

The current ICR rules allow capitalization until the added interest equals 10 percent of the original principal, and after that the interest is treated the same as for unsubsidized loans in IBR. The treatment of interest in ICR should be changed to match the treatment in IBR.

Income percentage factors. ICR has a payment adjustment factor based on the borrower's income level (published annually by the Secretary). This has the benefit of reducing the maximum required payment for low-income borrowers with relatively low debt (a situation in which the standard formula could lead to unmanageably high repayment requirements). These payment reductions should be maintained in ICR and added to IBR.

However, the current ICR payment adjustment factor also increases the maximum payment for high-income borrowers. Since borrowers can freely enter and exit ICR and soon IBR as well, these borrowers can avoid the higher payments by switching back and forth between programs. To simplify the system and align borrower incentives with the Department's interest in administrative efficiency, there should be no payment adjustment factor greater than 1.0 in ICR. As a result, the maximum payment for borrowers in both ICR and IBR would not exceed the standard repayment amount as specified in each plan.

Protected income. The intent of both programs is to keep loan payments from causing undue hardship for borrowers. However, they currently use different criteria for determining how much of a borrower's earnings can be tapped for repayment. The IBR repayment formula, which is defined in statute, protects all income below 150 percent of the poverty level for the borrower's family size and 85 percent of income above that baseline. ICR only protects income below 100 percent of the poverty level for the borrower's family size and 80 percent of income above that baseline. The ICR income protection levels should be adjusted to match those in IBR.

Loan Forgiveness for Public Service Employees

Student debt can deter qualified college graduates from entering or remaining in important but lower paying fields such as social work, teaching, and public safety. This program is intended to encourage and reward public service by forgiving outstanding student loan balances after borrowers work in eligible jobs for at least ten years and make certain payments through the Direct Loan program. We support rules that will make this important benefit clearly and easily accessible to those who serve their fellow citizens, country and community.

Qualifying jobs. The statute is clear that full-time employees in government, military service, and 501(c)(3) non-profit organizations are among the intended beneficiaries of this program. The rules should:

- Confirm that all employees in these sectors are eligible, regardless of the specific job they hold;
- Explain the circumstances under which borrowers in other professions named in the statute qualify if they fall outside of these three sectors; and
- Rely on the employer's definition of "full-time," so long as it does not exceed 40 hours per week.

Confirmation of qualifying employment. Borrowers should be able to confirm their qualifying employment on a yearly basis. This will help borrowers and the Department avoid the complications and administrative burdens associated with tracking down, submitting, screening and processing past employment records ten or more years from now. The rules should direct the Secretary to set up, or work with a contractor to establish, a user-friendly system for year-by-year employment confirmation.

Relationship to other loan forgiveness programs. Some borrowers in qualifying jobs may also be eligible for pre-existing government and private profession-related loan forgiveness programs. For example, there are federal loan forgiveness programs for certain teachers, members of the military, and public health professionals based on varying combinations of years of service and types of service, and offering different benefit levels. The rules should ensure that borrowers who apply for and receive partial loan forgiveness through other programs, before they complete ten years of qualifying employment, can later apply for and receive forgiveness of the remaining balance under the new program.

Minimum qualifying periods. The statute is clear that the ten years of qualifying employment do not have to be consecutive. The rules should clarify what, if any, minimum increments will be counted towards the ten-year total. We recommend that two months (eight weeks) be considered the minimum increment.

Ensuring Awareness of and Access to Fair Payments

To benefit from both new and existing loan repayment and forgiveness programs, borrowers must be made aware of the full range of repayment and forgiveness options and have easy and timely access to all pertinent information. The Department should hold lenders accountable for informing each borrower about all of her options, especially if that borrower's financial circumstances change over time. Interested borrowers must also be able to get accurate and up-to-date information about IBR and Public Service Loan Forgiveness directly from the Department in the months before regulations are finalized. To ensure awareness of and access to fair payments, we recommend the following:

Due diligence. Lenders, servicers and guarantors should have a clear and enforceable responsibility for helping borrowers identify the best repayment plan for their circumstances, as well as informing borrowers that they can change plans if their circumstances change. If lenders fail to do so, they should lose their guaranty. Borrowers who face any runaround from lenders should be able to consolidate (or reconsolidate) into a Direct Loan, since all options are available there.

To prevent defaults, current Education Department rules require lenders to carry out a series of loan collection attempts whenever a borrower is delinquent. These "due diligence" regulations (682.507) should be amended to require lenders, when a borrower is first delinquent on a loan, to notify the borrower of the availability of Income Based Repayment as well as the ability to consolidate into a Direct Loan to access ICR. The Department should also require lenders, servicers and guarantors to provide information to all borrowers about available loan forgiveness programs.

Information registry. While borrowers understand that some of the details of IBR and Public Service Loan Forgiveness need to be worked out, they still want to be kept informed. The Secretary would calm a lot of nerves, as well as maximize administrative efficiency in handling borrower inquiries, by setting up a way for individuals to register their interest and find out when new information becomes available. The Department should also create a web page with the most current information about these programs and conduct trainings about the new programs for 800-number staff and other employees who have direct contact with students and borrowers. To get the word out about Public Service Loan Forgiveness in particular, the Department should notify all eligible employers and provide them with information for their employees.

TEACH "Grants"

This program is highly problematic in its design, and it would be best if it were not implemented at all. While some aspiring teachers may ultimately benefit from the so-called "grants," many more will end up with higher loan and/or interest debt than they would if the program did not exist. The program has three fundamental problems.

First, the label is false and misleading. The "grants" are, in fact, unsubsidized Stafford loans (see Sec. 420N(c)). The only difference is that these loans are forgiven if the recipient teaches particular subjects in particular schools for a particular length of time. The vast majority of recipients are unlikely to meet all the criteria, so they would ultimately experience the so-called grants as loans.

Second, students cannot know what their future holds. If you could be sure that you will actually turn out to be good teacher and there will be a job in the right type of school teaching the right subject for the required number of years, then you should take the TEACH loan confident that it will be forgiven. However, if you cannot predict the exact trajectory of your future career (which few young people can or should) and have any financial need, then you should take a subsidized Stafford loan instead. If you take the unsubsidized TEACH loan and do not end up meeting all the criteria for forgiveness, you will owe nearly $3,000 more because of capitalized in-school interest[3]. In addition, you will face higher interest rates in repayment, because the new interest rate reduction applies only to subsidized Stafford loans.

[3] When a student borrows a total of $15,500 over four years of college (the maximum amount she could also take out in Subsidized Stafford loans), she will owe $2,836.86 in capitalized interest upon graduating (assuming a 6.8% annual interest rate, accrued quarterly).

Third, students will end up with more debt and/or miss out on real grant aid. If colleges decide to treat TEACH loans as if they are grants in student's financial aid packages, then many of the students who receive them will likely graduate with the current average of about $20,000 in loans plus up to $16,000 of these additional loans masquerading as grants. Those who are unable to jump through the loan forgiveness hoops will be far more indebted than they would have been without the program. Those who do get the TEACH loans forgiven may be no better off than if the program did not exist, because these loans displaced real grants that would otherwise have been part of their financial aid package.

If this program is implemented, the regulations should require all participating colleges and universities to:

- Treat and label the awards as loans in financial aid offers;
- Provide all of the counseling and information required for other borrowers of federal loans; and
- Inform potential recipients of the estimated proportion of students in the program who are actually predicted to fulfill all of the requirements for forgiveness.

Other Issues

Ensuring that loan forgiveness does not create new hardships. Debt forgiven through the new Public Service Loan Forgiveness program is clearly exempt from taxation. Section 108(f) of the Internal Revenue Code specifically exempts the discharge of certain types of student loans if they are part of a government- or charity-sponsored program that encourages people to enter certain professions. (This exemption will also apply to forgiven TEACH loans if the program is implemented.)

However, outstanding student-loan debt forgiven through IBR and ICR may still be subject to taxation. This undermines the fundamental goals of these programs, because borrowers who meet their income-based forgiveness criteria are the most likely to face significant hardships from a resulting tax liability. The Department should work with the IRS to ensure that amounts forgiven under ICR and IBR are not considered income for tax purposes.

Fixing the medical review process for disability discharge requests. The standards for discharging student loans due to disability are very difficult to meet, and at a minimum they should be applied equitably and evenly. Unfortunately, the current process for reviewing disability discharge requests is neither fair nor consistent.

In particular, the treatment of both doctors and borrowers in the medical review process can leave even severely disabled borrowers without reasonable recourse. Doctors are often given unrealistic time tables to respond, such as three days. Borrowers are not notified if a doctor fails to provide follow-up information in the time allotted; they only find out when they receive a denial based on "medical review failure." Doctors who fill out the forms in good faith are not alerted to the likelihood that they will be required to submit additional information nor given the opportunity to provide additional information up-front. To ensure that the process gives disabled borrowers meaningful access to this important relief, we recommend that the Department be required to:

- Give doctors at least 30 days to respond to follow-up requests for information. This period should be extended if there are extenuating circumstances.

- Notify borrowers – prior to denying their discharge request – if a doctor fails to reply to requests for additional information, and give borrowers a reasonable amount of time, up to 30 days, to contact their doctor and try to resolve the delay.

- Notify doctors that they will likely be contacted for additional information after completing the discharge form, and develop a system that would allow doctors to provide this information with the initial application.

*Treating financial hardship claims equitably in debt collections and offse*ts. All student loan borrowers should have the same rights to raise hardship claims when facing collection, and their claims should be judged by fair and consistent standards. Currently, a borrower's right to request a reduction in collection due to hardship, or to raise hardship as a defense to a collection action, may be evaluated differently depending on the type of collection action or may not be recognized at all.

Currently, wage garnishment through the Debt Collection Improvement Act specifically states at 34 C.F.R. 34.7: "We consider objections to the rate or amount of withholding only if the objection rests on a claim that withholding at the proposed rate or amount would cause financial hardship to you and your dependents." This same language should be added to the guaranty agency wage garnishment hearing provisions at 34 CFR §682.410, to the tax refund hearing provisions at 34 C.F.R. §30.33 et seq., and to offset (wage garnishment) provisions at 34 C.F.R. §30.20.

Thank you for this opportunity to provide input into the negotiated rulemaking process. Please do not hesitate to contact me if you have any questions regarding our recommendations.

Sincerely,

Lauren J. Asher
Associate Director
Project on Student Debt
2054 University Ave., Suite 500
Berkeley, CA 94704
(510) 559-9509
ljasher@ticas.org