

# THE SELF-DEFEATING CONSEQUENCES OF STUDENT LOAN DEFAULT

OCTOBER 2018

Every year, more than 8 million American students take out a total of over \$80 billion in federal student loans to help pay for college.<sup>1</sup> Bachelor's degree recipients from public and private nonprofit colleges now graduate with an average of \$28,650.<sup>2</sup> For many students, these loans are a worthwhile investment, paving the way towards better jobs and better lives. However, a growing number of borrowers struggle to repay their loans. One million students defaulted within the last year, and a record 8.9 million federal student loan borrowers are in default as of June 2018.<sup>3</sup> Worryingly, the number of borrowers in default continues to grow despite a strong economy and the availability of flexible repayment options.

For students, default can inflict long-term damage to their future economic prospects. Borrowers who have some college but no degree — a group some states have identified as a key part of their strategy to produce more college graduates — are particularly susceptible to default. As detailed below, national data show that these students, on average, have amassed a year or more of college credit. However, once they default, it may be difficult or impossible for them to return to college and finish their degree because they lose financial aid eligibility. They may also face long lasting consequences from lost employment opportunities due to default or suspended professional or driver's licenses.

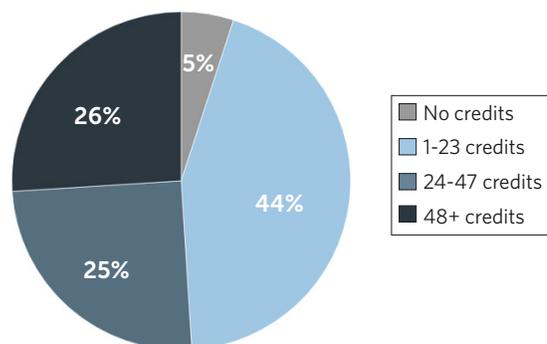
While the federal government has an obligation to try to collect what is owed on student loans, these punitive steps can be devastating for borrowers and families and self-defeating for taxpayers. They perversely make it even harder for struggling borrowers to return to school and regain their financial footing, even though graduating from college will make it easier to repay their loans.

## STUDENTS WITH SOME COLLEGE BUT NO CREDENTIAL MOST AT RISK FOR DEFAULT

Borrowers who do not complete a credential are significantly more likely to default than those who do. Overall, students who started college in 2003-04 but dropped out are more than twice as likely to have defaulted within 12 years as those who completed a credential within six years (23% vs. 11%).<sup>4</sup> This trend is true across all school types and student characteristics. Relative to completers, non-completers are twice as likely to default at public schools (14% vs. 6%), four times as likely to default at nonprofit schools (26% vs. 6%), and one-third more likely to default at for-profit schools (54% vs. 41%). Similarly, relative to completers, Black non-completers are 14 percentage points more likely to default (44% vs. 30%) and white non-completers are 10 percentage points more likely to default (17% vs. 7%).

Of these defaulters, over half (52%) had earned a year or more's worth of college credits (at least 24 credits) and over a quarter have completed two years of college (at least 48 credits).<sup>5</sup> In recent years, a number of states have focused on reengaging adults with some college but no degree as a strategy to raising overall degree attainment.<sup>6</sup>

### DISTRIBUTION OF CREDIT ACCUMULATION FOR NON-COMPLETERS WHO DEFAULTED



<sup>1</sup> Calculations by TICAS using the Department of Education's Federal Student Aid Data Center, Aid Recipients Summary and Direct Loan Volume reports, 2015-16 and 2016-17, <https://bit.ly/2IBILRv>. Figures include students who borrowed federal loans for their undergraduate or graduate education.

<sup>2</sup> The Institute for College Access & Success (TICAS). 2018. *Student Debt and the Class of 2017*. <http://bit.ly/2y0cONI>.

<sup>3</sup> Calculations by TICAS on data from the U.S. Department of Education, Federal Student Aid Data Center, <https://studentaid.ed.gov/sa/data-center>. Accessed September 19, 2018. Figures represent Direct Loan and FFEL borrowers whose loans are more than 360 days delinquent and the dollars outstanding in those loans. Borrowers with both Direct Loans and FFEL Loans in default are counted more than once.

<sup>4</sup> TICAS. 2018. *Students at Greatest Risk of Loan Default*. <http://bit.ly/2MUPzPg>.

<sup>5</sup> Calculations by TICAS using the U.S. Department of Education's Beginning Postsecondary Students Longitudinal Study (BPS), which follows undergraduate students who enrolled in college for the first time in 2003-04 and tracks their academic outcomes through 2008-09 and whether they defaulted on their federal student loans within 12 years of entering college.

<sup>6</sup> Wheatle, Katherine, Jason Taylor, Debra Bragg, and Julie Ajinkya. 2017. *The Potential of Degree Reclamation*. Institute for Higher Education Policy, <http://www.ihep.org/degree-reclamation>.

Moreover, because these students are disproportionately likely to belong to vulnerable groups, the consequences of student loan default are likely to exacerbate educational disparities. Among students who started college in 2003-04, did not complete a credential by 2009, and had defaulted on a student loan:<sup>7</sup>

- 23 percent were single parents, compared to 11 percent of all beginning students.
- 35 percent were black, compared to 16 percent of all beginning students.
- 46 percent had ever attended for-profit colleges, compared to 17 percent of all beginning students.
- 49 percent were first-generation, compared to 35 percent of all beginning students.
- 68 percent had incomes below 200 percent of the federal poverty line, compared to 41 percent of all beginning students.

## DEFAULT CREATES BARRIERS TO RETURNING TO SCHOOL OR SECURING EMPLOYMENT

Borrowers who enter default on federal student loans face an array of stark and immediate consequences, as detailed in the table to the right and summarized below. The entire loan balance becomes immediately due, and students may face a range of collection fees. The Department of Education has access to collection tools that include wage garnishment and offsetting tax refunds and other federal benefits, including social security. As a result, it estimates very high recovery rates for loans that enter default, even after accounting for collection costs and the time value of money.<sup>8</sup>

In addition, federal law imposes a range of punitive consequences that are unrelated to collecting what's due. Students with a defaulted loan may find it difficult to complete their education. Federal student aid is a central pillar of our college financing system. However, students with a defaulted loan lose eligibility for additional federal student aid and may have their academic transcript withheld.<sup>9</sup>

Defaulters may also find it difficult to find work on several fronts. Poor credit may disqualify defaulters from jobs. Additionally, 18 states suspend occupational, driver's, or other licenses upon default.<sup>10</sup> Those who have defaulted may also be less likely to obtain or maintain security clearances,

which are needed for a variety of jobs.<sup>11</sup>

With far-reaching impacts imperiling the ability to complete credentials, secure employment and housing, legally drive, and more, a defaulted loan can push individuals further into poverty and limit their ability to study or work their way out. These punitive measures are unnecessary, given the effectiveness of the other debt collection tools at the Department's disposal, and may even be self-defeating as they may worsen students' ability to repay their loans.

CONSEQUENCES OF DEFAULT	
<b>ACCELERATION</b>	Upon default, borrowers immediately owe the entire unpaid balance of their loan including any accumulated interest.
<b>ACCESS TO STUDENT LOAN BENEFITS</b>	Defaulters may not receive deferment or forbearance, choose a repayment plan, or access other student loan benefits.
<b>COLLECTION FEES</b>	Defaulters may be charged collection fees by their loan holders.
<b>TREASURY OFFSET</b>	Tax refunds and federal benefit payments may be withheld and applied toward repayment of defaulted loans.
<b>WAGE GARNISHMENT</b>	Employers may be required to withhold a portion of pay to send to loan holders to repay defaulted loans.
<b>CREDIT SCORE</b>	Defaults are reported to credit bureaus, damaging credit ratings.
<b>ABILITY TO PURCHASE OR SELL ASSETS</b>	Defaulters may not be able to buy or sell assets such as real estate
<b>LEGAL PROCEEDINGS AND FEES</b>	Defaulters may be taken to court by loan holders and charged court costs and attorney's fees.
<b>FEDERAL STUDENT AID ELIGIBILITY</b>	Defaulters may not receive additional federal student aid.
<b>ACADEMIC TRANSCRIPT WITHHOLDING</b>	Schools may withhold academic transcripts of those in default.
<b>LICENSE SUSPENSION</b>	18 states suspend occupational, driver's, or other licenses upon default.

## EXITING DEFAULT CAN BE COSTLY AND CONFUSING

There are a number of ways for students to resolve their defaulted student loans and earn restored eligibility for federal student aid. To exit default, borrowers have three choices: full repayment, where they pay off their loan balance entirely; loan rehabilitation, where they make nine consecutive on-time monthly payments, as set by their debt collector based on their financial circumstances; and loan consolidation, where they refinance their defaulted debt with a new Direct Consolidation Loan.

<sup>7</sup> Calculations by TICAS using the U.S. Department of Education's Beginning Postsecondary Students Longitudinal Study (BPS), which follows undergraduate students who enrolled in college for the first time in 2003-04 and tracks their academic outcomes through 2008-09 and whether they defaulted on their federal student loans within 12 years of entering college.

<sup>8</sup> For example, see Department of Education. "Student Loans Overview", p. Q34: FY 2019 Cohort Lifetime Dollar Default and Recovery Rates. <http://bit.ly/2NQ27bq>.

<sup>9</sup> Federal Student Aid (FSA). 2018. "Getting Out of Default." <http://bit.ly/2xL0uBG>.

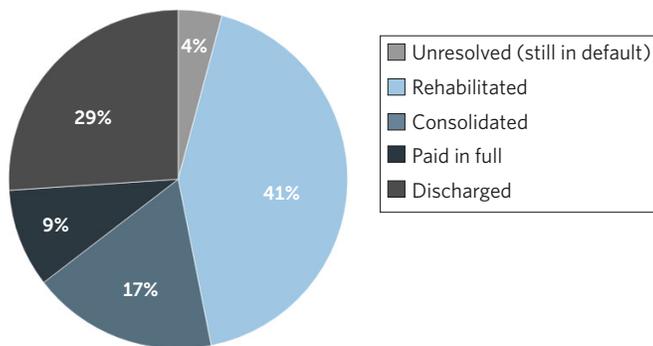
<sup>10</sup> Dieterle, C. Jarret, Shoshana Weissmann, and Garrett Watson. 2018. *How States Use Occupational Licensing to Punish Student Loan Defaults*. R Street, <http://bit.ly/2xK5TsS>.

<sup>11</sup> Stratford, Michael. August 9, 2018. "Veterans groups concerned with DeVos 'borrower defense' plan." *Politico*, <https://politi.co/2DDmjbM>.

Recent research documents that many defaulters use one of these options to exit default, with as many as 70 percent of defaulters exiting default within five years.<sup>12</sup> However, there are no data on what burden doing so may have imposed on the livelihoods of borrowers as they worked to exit default, nor on how it affected their educational and employment opportunities; effects which can linger and compound, creating long-term costs. The fees alone for exiting default can range from nominal to substantial.<sup>13</sup>

Additionally, some of these students reenter default. About one in 10 Direct Loan borrowers who enter default do so on loans that had previously defaulted (i.e., are defaulting for at least the second time).<sup>14</sup> Looking at borrowers who rehabilitated their defaulted loans, the CFPB recently found that nearly one in three borrowers ended up defaulting for a second time within 24 months, and over 40 percent of borrowers redefaulted within three years.<sup>15</sup> Moreover, many borrowers who did not complete their credentials remained in default. Among the students we examined, — students who started college in 2003-04, did not complete a credential by 2009, and had defaulted on a student loan — 41 percent of them still have their loans in default in 2016.<sup>16</sup>

**STATUS OF DEFAULTED LOANS FOR NON-COMPLETERS**



Students who exit default can regain financial aid eligibility, but the standards are complicated and confusing. Borrowers who rehabilitate their loans can regain eligibility after six on-time payments. Borrowers who consolidate their loans regain eligibility immediately if they either agree to participate in income-driven repayment or make three on-time

<sup>12</sup> Delisle, Jason, Preston Cooper, and Cody Christensen. 2018. *Federal Student Loan Defaults: What Happens After Borrowers Default and Why*. American Enterprise Institute, <http://bit.ly/2N5duqF>.

<sup>13</sup> Delisle, Jason, Preston Cooper, and Cody Christensen. 2018. *Federal Student Loan Defaults: What Happens After Borrowers Default and Why*. American Enterprise Institute, <http://bit.ly/2N5duqF>.

<sup>14</sup> Calculations by TICAS using the Department of Education’s Federal Student Aid Data Center, New Direct Loan Defaults, <https://bit.ly/2Rs7IbK>. Figures include borrowers who defaulted on their federal Direct Loans in the quarters between October 1, 2014 and September 30, 2017.

<sup>15</sup> Consumer Financial Protection Bureau. 2017. *Update from the CFPB Student Loan Ombudsman: Transitioning from default to an income-driven repayment plan*. <https://bit.ly/2pznjE3>.

<sup>16</sup> Calculations by TICAS using the U.S. Department of Education’s Beginning Postsecondary Students Longitudinal Study (BPS), which follows undergraduate students who enrolled in college for the first time in 2003-04 and tracks their academic outcomes through 2008-09 and whether they defaulted on their federal student loans within 12 years of entering college.

payments. Finally, borrowers who repay their full outstanding balance regain eligibility immediately, but they may pay the most in collection fees.<sup>17</sup> These practices are unfair, illogical, and unnecessarily complex.

## STRATEGIES TO BETTER PREVENT AND MORE PRODUCTIVELY CURE DEFAULT

If we want to increase educational attainment and facilitate employment, it is imperative that student loan policies not make it harder than it needs to be for struggling borrowers to get back on their feet. The following are some key ways that state and federal policymakers can help students repay their loans while improving educational outcomes.

- **Examine and Eliminate Punitive Practices That Make It Harder to Exit Default.** Congress should make changes that enable students to re-enroll in school and more quickly access federal aid that they would otherwise be eligible for, even as they work toward exiting default. Having the opportunity to pursue further schooling and complete credentials sooner would likely put those borrowers in better position to be able to repay their loans. Additionally, Congress, along with the Department of Education, Consumer Financial Protection Bureau (CFPB), and other relevant federal agencies, should explore potential improvements to the transition between default and repayment. For example, the CFPB has identified major problems with the transition between rehabilitation of defaulted loans and successful repayment under income-driven plans.<sup>18</sup> Finally, Congress should disallow state suspension of occupational, driver’s or other licenses due to student loan default. Such consequences are unnecessarily punitive, are counterproductive to goals of bringing defaulted loans into good standing, delaying or preventing default exit, and should not be practiced.
- **Protect Students Against Low-Value Programs.** The gainful employment rule is a critical safeguard that prevents hundreds of thousands of students from taking on debts they are unlikely to be able to repay. It has already proven its effectiveness, as colleges and trade schools have strengthened the value of the programs they offer students and closed the programs they could not improve. It will save taxpayers \$5 billion over 10 years by eliminating subsidies to low-value programs. The Department of Education should immediately implement the rule, not attempt to repeal it.<sup>19</sup>

<sup>17</sup> See: 2018-19 Federal Student Aid Handbook Volume 1: Student Eligibility, Chapter 3, NSLDS Financial Aid History at <https://ifap.ed.gov/fsahandbook/attachments/1819FSAHbkVol1Ch3.pdf>.

<sup>18</sup> Consumer Financial Protection Bureau. 2017. *Update from the CFPB Student Loan Ombudsman: Transitioning from default to an income-driven repayment plan*. <https://bit.ly/2pznjE3>.

<sup>19</sup> TICAS. 2018. “TICAS Detailed Comments on the Gainful Employment Rule.” <http://bit.ly/2NKpGCx>.

- **Make It Easier to Repay Student Loans.** Income-driven repayment (IDR) plans provide a critical safeguard against default, but more must be done to ensure borrowers who stand most to benefit from IDR can enroll and continue making affordable payments in an IDR plan.<sup>20</sup> Congress should streamline the current, confusing array of available IDR plans into a single, improved plan, and pass the bipartisan SIMPLE Act, which automatically enrolls severely delinquent borrowers into IDR and automates key annual income certification processes to reduce the currently high rate at which borrowers miss these deadlines and risk unaffordable spikes in their required monthly payments.<sup>21</sup>
- **Overhaul Student Loan Servicing.** It is imperative that the Department of Education improve oversight of loan servicers by developing and enforcing consistent standards of high-quality service. This includes following through with its intent to implement long-outstanding recommendations from the Government Accountability Office (GAO) through the Department's NextGen Servicing redesign initiative.<sup>22</sup> While strong federal action remains overdue, states can adopt a Student Loan Borrower Bill of Rights to prevent borrowers from being poorly served or misled by the companies that collect student loans.
- **Provide Full Loan Discharges to Students When Applicable.** Students who are left with unaffordable debt as a result of their school suddenly closing, or because they were lured into enrolling in and borrowing for a worthless program deserve the full relief they are entitled to under the law and as provided under the 2016 borrower defense rule. Gutting this rule, and requiring that students enter default to be eligible for relief, as has been recently proposed by the Department of Education, will drive up default rates. The Department should immediately implement the 2016 rule and further strengthen student protections.<sup>23</sup>
- **Provide Students Clear, Timely, and Relevant Information.** Students who need to borrow to attend and complete college need clear information on their loan options and obligations. Although providing consumer-friendly information through improved loan counseling will not, by itself, reduce burdensome student debt payments, it is key to ensuring that students are at least equipped with the

necessary understanding of expected costs and repayment obligations, as well as options for relief. Federally required student loan counseling should clearly and consistently convey to students key information about expected costs of borrowing, how to enroll in or change repayment plans, how to contact their servicers for assistance, and where and how to file complaints when their servicers fail to adequately provide the required support.

- **Empower Colleges to Understand Default Risk and Implement Default Reduction Strategies.** Colleges can and should take proactive measures to reduce default by implementing robust debt management plans.<sup>24</sup> Successful default reduction efforts involve the whole campus and target interventions to students at the most risk of non-completion and therefore at higher risk of default. The Department of Education can also support these efforts by disseminating resources on identified best practices, making the National Student Loan Data System (NSLDS) more accessible by campus staff, and providing guidance on how to use the data for default prevention.
- **Reduce Student' Need to Borrow.** The best way to prevent default is to reduce students' reliance on debt to begin with. States and institutions can help reduce student debt by prioritizing financial need in their allocation of available grant aid. Congress should also work toward doubling the maximum federal Pell Grant to close disparities and permanently index the grant to inflation to maintain the grant's value going forward.<sup>25</sup> Streamlining higher education tax benefits would also help ensure that federal financial supports are more effectively targeted at students with the greatest financial need.<sup>26</sup>

Given the serious nature of the consequences default brings for already struggling student loan borrowers, it is past time that we revisit our commitment to preventing default in the first place, as well as the process we require borrowers to navigate when they do default.

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<sup>20</sup> TICAS. 2017. *Make it Simple, Keep it Fair: A Proposal to Streamline and Improve Income-Driven Repayment of Federal Student Loans.* <http://bit.ly/2haTM3c>.

<sup>21</sup> TICAS. Press Statement. 2017. "New Bipartisan SIMPLE Act Would Significantly Reduce Federal Student Loan Defaults." <http://bit.ly/2xYBS8P>.

<sup>22</sup> U.S. Government Accountability Office. 2018. "Federal Student Loans: Further Actions Needed to Implement Recommendations on Oversight of Loan Servicers." <https://www.gao.gov/assets/700/693475.pdf>.

<sup>23</sup> TICAS. 2018. "TICAS Detailed Comments on Borrower Defense to Repayment Rule." <http://bit.ly/2xLEc2T>.

<sup>24</sup> For more, see: Association of Community College Trustees & The Institute for College Access & Success. 2014. *Protecting Colleges and Students: Community College Strategies to Prevent Default.* <http://bit.ly/2xJg4Ob>.

<sup>25</sup> TICAS. 2018. "How to Secure and Strengthen Pell Grants to Increase College Access and Success." <http://bit.ly/2OnHkLK>.

<sup>26</sup> TICAS. 2017. "TICAS Recommendations to Senator Hatch on Reforming Federal Education Tax Benefits." <http://bit.ly/2OiTndf>.