July 15, 2016

Dear Undersecretary Mitchell,

As organizations working on behalf of students, consumers, veterans, and civil rights, we write to provide our recommendations on how the Department can create a system that promotes quality and consistent servicing by ensuring accountability, properly aligning servicer incentives, and creating appropriate standards.

Promoting Accountability

The Department's current efforts to overhaul a broken system and make sure that servicers put borrower needs first are encouraging. As this administration has repeatedly acknowledged, accountability is critical to ensuring that borrowers receive quality servicing.[1] Unfortunately, we are deeply troubled by the Department's announcement that the finalists to develop this platform are the very same servicers – Navient, FedLoan Servicing, Great Lakes, and NelNet – that have a documented history of "widespread servicing failures" that "create obstacles to repayment, raise costs, cause distress" and "driv[e] borrowers to default."[2] A single servicing platform should not be developed by a company with a record of harming students or members of the military,[3] an entity that does not believe federal consumer protection laws apply to it,[4] or companies that have been accused of overbilling the Department by hundreds of millions of dollars.[5]

In order to have true accountability, there must be real consequences when servicers violate the law, including sanctions, loss of contracts, and public and private enforcement. When selecting a finalist here, and in future awards, the Department must consider past investigations, lawsuits, and settlements for violations of state or federal consumer protection laws or laws meant to protect students and members of our armed services, including evidence of wrongdoing compiled by state and federal law enforcement agencies. Moving forward, the Department should consider complaints from students and borrowers, meaningful complaint resolution on the

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[1] Department of Educ., Department of Education, Department of Treasury and the Consumer Financial Protection Bureau Issue Joint Principles on Student Loan Servicing (Sept. 29, 2015), http://www.ed.gov/news/press-releases/department-education-department-treasury-and-consumer-financial-protection-bureau-issue-joint-principles-student-loan-servicing.

[2] Consumer Financial Protection Bureau. "CFPB Concerned About Widespread Servicing Failures Reported by Student Loan Borrowers," September 29, 2015, available at http://www.consumerfinance.gov/about-us/newsroom/cfpb-concerned-about-widespread-servicing-failures-reported-by-student-loan-borrowers/.

[3] U.S. Department of Justice. "Justice Department Reaches $60 Million Settlement with Sallie Mae to Resolve Allegations of Charging Military Servicemembers Excessive Rates on Student Loans," May 13, 2014, *available at* https://www.justice.gov/opa/pr/justice-department-reaches-60-million-settlement-sallie-mae-resolve- allegations-charging. Federal Deposit Insurance Corporation. "FDIC Announces Settlement with Sallie Mae for Unfair and Deceptive Practices and Violations of the Servicemembers Civil Relief Act," May 13, 2014 *available at* https://www.fdic.gov/news/news/press/2014/pr14033.html.

[4] Natalie Kitroeff. "Court Rules That Student Loan Company Isn't Above the Law," Bloomberg, October 23, 2015, available at: http://www.bloomberg.com/news/articles/2015-10-23/court-rules-that-student-loan-company-isn-t-above-the-law.

[5] U.S. Department of Justice. "Four Student Aid Lenders Settle False Claims Act Suit for Total of $57.75 Million," November 17, 2010, *available at* https://www.justice.gov/opa/pr/four-student-aid-lenders-settle-false-claims-act-suit-total-5775-million.

part of servicers, and the findings and actions of the Enforcement Unit or other bodies performing oversight of servicing.

Private enforcement is particularly critical. The federal agencies and state Attorneys General play important roles in protecting student loan borrowers. A number of factors, however, limit the impact of public oversight. Agencies can only act selectively and cannot address the vast majority of individual violations. Additionally, because citizens are more likely than government agencies to be aware of practices that cause borrowers harm, suits by individuals can actually drive regulation and reform by exposing bad practices. This is why the enforcement system must be multi-faceted, including public oversight and enforcement, a robust public and searchable complaint and escalation system, and private enforcement rights.

There are a number of ways the Department can create privately enforceable rights, including:

- Stating in the contracts and promissory notes that borrowers are beneficiaries of the servicing agreement and have the right to enforce the servicer obligations that pertain to borrowers;
- Conditioning the lenders' and servicers' right to accelerate and declare default on the student loan on compliance with the servicing standards; and
- Creating separate servicing contracts between servicers and borrowers that affirm the rights and obligations in the promissory notes and contracts, including servicer obligations that pertain to borrowers.

Accountability also requires the Department to be proactive. Though there have been improvements in the past few years, recent GAO and Inspector General studies confirm that federal and state enforcement of Higher Education Act requirements has been lax.[6] Furthermore, where the Department has investigated its servicers, it has failed to be sufficiently rigorous. Improving oversight begins with subjecting contracted and subcontracted student loan servicers to scheduled and surprise worksite inspections and examinations. Department staff need to have access to the servicing system that allows them to listen to any stored call and review any account information without needing to request it from the servicers. Effective oversight also means that the Department must collaborate with other federal agencies and state Attorneys General to ensure that the servicers it contracts with are in full compliance with federal and state consumer protection laws.

The Department has taken an important first step in developing the feedback system so that borrowers can submit complaints, but it should go further. In order to maintain a strong and effective complaint system, it must be public and searchable, provide effective results for borrowers, and have robust oversight.

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[6] U.S. Dep't of Educ., Office of Inspector Gen., Control No. ED-OIG/A04N0004, Final Audit Report (Aug. 24, 2015); U.S. Dep't of Educ., Office of Inspector Gen., Handling of Borrower Complaints Against Private Collection Agencies, Control No. ED-OIG/A06M0012 (July 2014); Federal Student Loans: Oversight of Defaulted Loan Rehabilitation Needs Strengthening: Testimony Before the H. Subcomm. on Higher Educ. and Workforce Training, Comm. on Educ. and the Workforce, 113th Cong. 8 (2014), available at www.gao.gov (statement of Melissa Emrey-Arras, Dir., Educ., Workforce, and Income Sec., U.S. Gov't Accountability Office).

Incentivizing High Quality Servicing and Creating Real Competition

We know from experience that servicers tend to act according to financial incentives. With this in mind, it is critical that the Department structure its contract in a way that promotes high quality servicing. We make the following recommendations.

Compensation

1. **Experiment with Multiple Compensation Models**

The new servicing structure should reflect the fact that we do not have all the answers on the best way to pay servicers. Accordingly, it should leave room for experimentation with new payment models. Such experiments could include:

- Special high-risk servicing pools where servicers are paid more for keeping riskier borrowers current, and potentially less for borrowers more likely to repay. This could include risk factors like the school a borrower attended, the borrower's completion status, the loan balance, the amount of time in school, or other characteristics.
- Second-chance default aversion where extremely delinquent borrowers can be transferred to other servicers who attempt to get them current. Servicers would be rewarded for more effectively servicing these individuals' delinquencies, while those who originally worked the account would be judged on how many of their severely delinquent accounts get fixed by others.
- Different compensation depending on the borrower's level of educational attainment to acknowledge that students who already earned a bachelor's degree carry a much lower default risk.
- Bonus payments for long-term success for previously delinquent borrowers: Servicers should be encouraged to not just get delinquent borrowers current, but also keep them there. A new compensation model should experiment with giving servicers small rewards when a borrower who was previously in a severely delinquent status hits milestones like making three, six, or nine on-time payments.

2. **Provide Set Payments for Administrative Resolutions**

A new compensation model should increase the flat payments given to servicers for resolving borrower cases in such a way that will not result in future monthly payments (e.g. discharges for closed schools, death or permanent disability, or other cases where borrowers will not continue to pay). This acknowledges that there are costs associated with administrative resolutions that will not otherwise be recouped. While the existing model does include some payments for this purpose, they generally seem to be very low (such as $52 for completing a total and permanent disability discharge application). That's much less than the $150 debt collectors receive for similar resolutions, and even that amount may be too low.

3. **Differentiate Compensation For Deferment And Forbearance**

While deferment and forbearance may be useful tools for some borrowers, such as those going back to school or transitioning between repayment options, use of these tools in other situations or for an extended period of time may be cause for concern. Accordingly, new compensation terms should reduce per-borrower payments even further for uses of deferment or forbearance not tied to being in-school, military, Peace Corps, or other public service, teacher loan forgiveness, required medical/dental internships, or for processing borrower applications for income-driven repayment. And this compensation should continue decreasing the longer a borrower stays on one of these statuses.

4. **Focus Less On Extremely Short Term Delinquency**

Creating financial incentives for borrowers to stay current is extremely important, but the current structure starts reducing the per-borrower payment as soon as a borrower is six days delinquent. This generates a lot of activity for borrowers that may easily self-cure. Any reduction in payments should not start until a borrower is at least 30 days delinquent.

5. **Tie Compensation Drop-Offs To Delinquency Data**

Servicers should receive lower per-borrower payments as loans become more delinquent. But to figure out the proper way to reduce payments, the Department should conduct an analysis of its portfolio to determine the points of delinquency when less than 75 percent, 50 percent, 25 percent, and 10 percent of borrows eventually cure their delinquency and stay current. Those points should be used as the triggers for when per-borrower payments to servicers should significantly decrease.

6. **Provide One-Time Payments For Initial Income-Driven Repayment Applications**

Getting borrowers onto income-driven repayment is costly and time consuming. To recognize this, the Department should consider providing servicers with a one-time payment for the successful completion and processing of an income-driven payment application. This will provide a financial reward for getting borrowers into such a plan. As stated, there should be experimentation to determine the appropriate amount in order to adequately compensate servicers without encouraging inappropriate steering.

Performance Measurement

1. **Judge Servicers By Relative Performance**

The Department should take into account *how much* servicers outperform each other, rather than just whether or not they outperform. Doing so both rewards outsized performance and holds servicers accountable when they achieve only poor or middling results.

Currently, servicers are simply ranked from best to worst on a given measure, with declining points given for those who fare worse. This setup treats a third place finisher the same regardless of whether it is 0.5 percentage points or 5 percentage points behind the leading servicer. Dramatically worse performance compared to the leading servicer in a category should receive far fewer points, while someone who is barely behind the best should not lose as many points.

The scoring model used in the past for student loan collection agencies provides one way to incorporate relative performance.

2. **Ensure Consistent Measurement Cohorts**

Servicers should be judged in a way that ensures that they do not outperform each other simply due to the type of accounts they have and not the service they provide. This means accounting for differences in the relative age of servicing portfolios, as well as the characteristics of the borrowers (such as veteran status, whether they attended a proprietary institution, whether they completed their degree, and other risk factors for default). This is necessary to ensure a fair comparison.

3. **Create performance measures for special populations:**

Servicers should be held accountable not just for the overall results of their portfolios, but also for their success with specific types of at-risk borrowers. This encourages a special focus on individuals we are most concerned about. While the Department should conduct a borrower-level analysis to identify the specific populations, this should focus on individuals who are at a higher risk of default.

4. **Create Measurements For Specific Outcomes**

The new accountability structure should consider more discrete measures targeted at judging how well servicers do on a variety of different outcome measures, not just at topline measures like overall repayment rates. Specific outcomes to measure should include:

- Re-default rate of borrowers who rehabilitated or consolidated out of default.
- Re-certification rate of borrowers on income-driven payment plans.
- Number of complaints filed about a servicer and how well a servicer addresses complaints for the borrower.

Creating Standards that Promote Quality Servicing and Protect Borrowers' Rights

As the Department develops baseline servicing standards, it should include standards that reflect borrowers' perspectives in alignment with the joint principles developed by the U.S. Departments of Education and Treasury, and the Consumer Financial Protection Bureau. Specifically, we recommend that the Department:

- **Let borrowers switch servicers:** Borrowers need to be provided the choice to switch student loan servicers if they feel that their servicer is failing to provide adequate servicing, or if they have filed numerous complaints with their servicer. This would require the Department to develop an escalated complaint process, in which borrowers are provided the opportunity to request that servicers investigate servicing errors and an opportunity to appeal the servicer's decision. For any student loan servicer that has a high volume of unresolved complaints, the Department should cease directing any new loans to that servicer until it is able to resolve the complaints, and it should add this metric into future loan allocation calculations.

- **Establish a single, ED-branded website and portal for loan servicing that is accessible on multiple technology platforms:** We support the Department's plan to create a single site to handle all parts of student loan repayment. The Department must ensure that the portal is smartphone accessible, with the ability for borrowers to sign documents electronically and to submit any needed forms from a smart phone browser. Low-income borrowers often have extreme difficulty finding access to printers. In addition, research by Pew has shown that 7% of Americans are almost entirely dependent on a smartphone to access the internet.[7]

- **Fully integrate with Studentloans.gov and NSLDS:** The new servicing platform should be constructed so that borrowers are able to fully manage their loans through a single login, rather than having to go back and forth between the servicing site and studentloans.gov. This means they must be able to do things like review loan balances, make payments, view repayment options, and sign up for income-driven repayment plans, among other issues. Servicers, meanwhile, must have better access to information about borrowers applying for income-driven repayment. This should include the ability to see when a borrower initiates an income-driven payment application, if the borrower gets stuck on an application, and other similar data. Doing so allows the servicer to know whether to start a chat window or reach out with some just-in-time assistance to a borrower who may be having difficulty. Finally, borrowers should also be able to retrieve through this portal all the information about their loans that they can currently get from the National Student Loan Data System.

- **Establish common standards for key issues involving flow of payments:** Borrowers and servicers need clear rules on important issues to ensure they are treated fairly. This is especially true for anything involving the flow of dollars. Accordingly, the Department should establish common servicing rules for at least the following issues:
    - Billing
    - Payment processing
    - Overpayment allocation
    - Underpayment allocation
    - Payoff statement generation
    - Viewing of payment history
    - Account transfers (including consolidation and rehabilitation)

- **Allow borrowers to schedule servicer phone calls:** Companies like Amazon and Netflix are creating customer service options that allow users to request that representatives call them at a specified time and number, often immediately, when an

[7] Pew Research Center. "U.S. Smartphone Use in 2015," (Apr. 1, 2015), *available at* http://www.pewinternet.org/2015/04/01/us-smartphone-use-in-2015/.

agent is free, or in five minutes. Creating similar options in the servicing platform will help reach more borrowers. It would also allow them to ensure they will not spend a lot of time on hold when they may have a narrow window for talking. Many low-income borrowers rely on prepaid cell phones or limited-minute plans and are unable to wait on hold for long periods.

- **Research and establish standards based upon best practices for borrower contact based upon characteristics:** There is no set number of contact attempts that is guaranteed to bring a delinquent borrower current, but all borrowers deserve certainty that communication will occur if they fall behind. The Department should research the efficacy of different modes of communication to establish standards for borrower contact. Over time, the Department should then refine these standards through careful review of the account histories of borrowers whose delinquencies are cured, adjusting the requirements up or down based upon what actual track records showed to be the most effective.

Role of specialized servicers

It's important that the Department recognize student loan servicing may affect certain populations more prone to default—such as service members, veterans, students that attended for-profit colleges and universities, non-college completers, and older Americans—at an increased level due to unique circumstances associated with these individuals. The Department must first do more research to understand which borrowers are most at risk and what sorts of interventions are most effective in preventing defaults for different populations. There is a shocking dearth of research on why borrowers default and the role of servicing in defaults. Although there has been some private study, the government is in the best position to research these issues as it has the most access to data and resources.

Specialized student loan servicing units could benefit borrowers, but carry risks as well, and should therefore be studied and assessed through a pilot program. Among other benefits, specialized units could allow the Department to provide groups of at-risk borrowers with well-trained customer service divisions that are particularly knowledgeable about these individuals' circumstances and options for repayment. In turn, the Department could provide better information and counseling to at-risk borrowers, potentially curtailing borrower default. If the Department is unable to build specialty servicing units, we suggest that each student loan servicer be required to develop internal specialized customer service units for at-risk populations.

Full servicer specialization, i.e. assigning certain populations to one servicer, is a relatively unexplored space within student loan servicing. There are inherent risks that come along with transferring borrowers to a single specialized servicer, for example, if a specialty servicer consistently fails to deliver competent service. We urge the Department to mitigate against the potential harms that could occur. Consequently, we do not believe that the Department should consider fully specialized student loan servicing without first conducting a pilot program so the public has measurable statistics on borrower outcomes and program costs. The Department can also review existing data trends of student loan borrowers in the above-mentioned at-risk categories to identify common problems.

Transparency

Relying on a proprietary contract system hidden from the public and from borrowers is not appropriate in the federal student loan context. Transparency is critical to having a servicing system that works for borrowers. We are encouraged to see the Department's promise to include standards and rights for borrowers; however, borrowers need to know their rights in order to enforce them.

The Department should make any procedure manuals and other instructions available to the public, including the underlying contracts as well as any modifications. As the National Consumer Law Center wrote in its 2014 report, *Pounding Student Loan Borrowers: The Heavy Costs of the Government's Partnership with Debt Collection Agencies*, many of the abuses in the student loan debt collection context are a direct result of the incentive structure and instructions found in the procedures manual.[8] Comments from the servicing industry reify these concerns. After settling a lawsuit with the Department of Justice for violations of the Servicemembers Civil Relief Act ("SCRA"), Jack Remondi, CEO of Navient, publicly stated that Navient's violations of the SCRA were a result of its having followed the Department of Education's guidance.[9] Unfortunately, when NCLC and the ACLU requested the procedures manual used by private debt collectors under the Freedom of Information Act, the Department provided only a heavily redacted copy.[10] This lack of transparency makes it nearly impossible to have a knowledgeable debate about how best to serve student loan borrowers.

In addition to making Department policies publicly available, the Department needs to collect and make publicly available the data that is necessary to evaluate whether its servicers are adequately performing their duties. In addition to the data on the Data Center website, the Department needs to include more detailed information including re-default rates, demographic information, and information related to its enforcement actions. The Department should also make its feedback system, where students can already submit complaints about servicing, public and searchable.

Finally, the development of these rights and policies should not happen in a vacuum. We appreciate the opportunity to provide input at this stage in the re-compete process; however, the Department should make a draft of these documents available and open to comment through Regulations.gov prior to their implementation. Additionally, the Department should respond to commenters to inform them of how submitted comments will be used and by whom, and release a timeline of when the Department will be soliciting public input on the single servicing platform, both during and after the solicitation.

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[8] NCLC, Pounding Student Loan Borrowers: The Heavy Costs of the Government's Partnership with Debt Collection Agencies (Sept. 2014), http://www.nclc.org/issues/pounding-student-loan-borrowers.html.
[9] Jack Remondi, Setting the Record Straight on SCRA, Medium.com (Mar. 13, 2016), https://medium.com/@JackRemondi/setting-the-record-straight-on-scra-e642fa370d0a#.2lpfahnii.
[10] *ACLU et al. v U.S. Dep't of Educ*., Case No. 1:16-cv-10613-ADB (D. Mass. 2016).

Thank you for your consideration. Please contact Persis Yu at pyu@nclc.org or (617) 542-8010 to discuss further.

Sincerely,

Americans for Financial Reform
Center for Responsible Lending
National Consumer Law Center (on behalf of its low-income clients)
National Council of La Raza
Veterans Education Success