Banking and Finance Law Daily Wrap Up, CONSUMER CREDIT—Student loan borrowers at risk for repeated defaults, CFPB warns, (Oct. 17, 2016)

Banking and Finance Law Daily Wrap Up

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One-third of student loan borrowers whose defaults are rehabilitated are likely to default again within the next two years, according to a report by the Consumer Financial Protection Bureau Student Loan Ombudsman. "[B]reakdowns in the federal programs designed to provide them a fresh start," including loan servicing practices and red tape, are trapping in default many borrowers who qualify for income-driven repayment (IDR) plans, said Ombudsman Seth Frotman. Some of these students redefault even though they would qualify for $0-per-month payments under federal programs, he said.

Outlining the problem. According to the Department of Education, more than 8 million federal student loan borrowers are in default. The CFPB estimates that more than one-quarter of student loan borrowers are either past-due or in default.

Student loan borrowers who are in default can rehabilitate their loans by making nine on-time monthly payments, which makes them eligible for IDR plans. Alternatively, they can refinance their loans using a Direct Consolidation Loan. The lowest income borrowers can rehabilitate their loans by making nine $5-per-month payments, and then qualify for $0-per-month payments, the CFPB report says.

In the last year, more than 650,000 borrowers took advantage of the $5-per-month payments, the CFPB estimates. However, more than 220,000 of them will redefault if policymakers and the student loan industry do not make necessary changes. In fact, the report cites a statement by an association of loan servicers and debt collectors that one-third of these borrowers will be delinquent within 60 days of completing the rehabilitation payments.

Borrower complaints. The report relates a number of complaints that student borrowers have raised about debt collectors and loan servicers that they say have pushed them back into default. These include difficulties in:

- setting up rehabilitation plans;
- calculating or making rehabilitation payments;
- transitioning to IDR plans after completing rehabilitation;
- communications between debt collectors that manage rehabilitation plans and servicers that manage IDR plans; and
- communications with servicers once IDR plans are in effect.

Recommended reforms. The ombudsman's report calls for changes that would make it easier for borrowers to set up IDR plans, noting first that Direct Loan consolidation might be a better route than rehabilitation for many borrowers. Better communication with borrowers as they move to IDR plans is needed.

One recommendation is changing the economic incentives of those who work with student borrowers. Debt collectors who manage the rehabilitation process have little incentive to work with borrowers once that process is over, the report says. It might be useful for servicers to make contact with borrowers even before the rehabilitation plan is completed.

RegulatoryActivity: CFPB ConsumerCredit