THE SECRETARY OF EDUCATION
WASHINGTON, DC 20202

DATE: June 30, 2023

MEMORANDUM TO: Richard Cordray
Chief Operating Officer
Federal Student Aid

FROM: Miguel A. Cardona
Secretary of Education

SUBJECT: Return to Repayment Protections

This memorandum directs Federal Student Aid (FSA) to implement a transition period as part of the return to repayment of federal student loans, based on evidence of significant problems for borrowers and FSA in effectuating that transition.

I. Background

The Department paused collections and interest charged on Department-held loans beginning in March 2020. Consistent with the Fiscal Responsibility Act of 2023, the Department will end the pause in August 2023. After that time, loans will accrue interest starting in September; borrowers will be required to make student loan payments starting in October; and borrowers who miss payments will generally no longer be credited with progress toward public-service or income-driven loan forgiveness.

We anticipate substantial challenges in helping borrowers return to repayment successfully. Once the pause ends, 28 million borrowers will enter or reenter repayment, more than 20 times greater than the number of borrowers who would typically enter repayment in a single month and five times more borrowers than would normally enter repayment in an entire year. These borrowers will return to a student loan system that is midstream in making fundamental reforms to student loan servicing and borrower benefits, at a time when FSA is managing multiple management priorities with constrained funding.

In preparation for the end of the payment pause, the Department has long been planning several steps to help borrowers manage their student loans, including a debt relief plan to prevent defaults and delinquencies for millions of Americans restarting payment and creating a more affordable Income-Driven Repayment (IDR) plan through regulation. FSA has also prepared to implement a transition process that will, for the reasons described below, help increase the number of borrowers who will make voluntary payments by temporarily delaying certain penalties for borrowers who are unable to make their initial payments in full while servicers work with borrowers. With payments set to resume shortly, I am now directing you to implement the transition process as described below.

II. Projected Problems with Return to Repayment

When the pause ends, 28 million borrowers will owe payments for the first time in at least three and half years. Just as before the pause, there will be borrowers that are able to make their payments. But there will also be significant numbers of borrowers who are not able to make a payment, putting them at risk of delinquency and default. These at-risk borrowers could include many borrowers who, prior to the pandemic, may have had the resources to navigate repayment successfully. The Federal student loan programs are complex, and it takes significant resources from both borrowers and servicers to navigate loan terms and conditions and to submit and process applications for programs that will help borrowers succeed in repayment. As discussed below, the Department faces multiple challenges in ensuring that borrowers can access the benefits to which they are entitled under the law and will have the support they need to avoid delinquency and default.

Borrowers leaving periods of forbearance are at higher risk of delinquency and default.[1] When the payment pause ends after 42 months, 28 million borrowers will be entering repayment after the longest payment pause, forbearance, or deferment in history. This period of forbearance will be far longer than anticipated when the Department first contemplated a transition process for returning borrowers to repayment.[2] Past experiences with administrative forbearances after natural disasters suggest it can take more than two years for repayment patterns to recover, after even administrative forbearances of only several months. FSA internal research shows that many borrowers say they are not prepared to begin to repay, and in a survey earlier this year, more than half of borrowers reported that their financial stability depends on the continuation of the payment pause.[3] Without action by the Department to make the transition manageable, the risks of very high rates of delinquency and default are extraordinary.

In restarting payments, the Department seeks to collect the funds that are due to taxpayers while also helping eligible borrowers benefit from the affordable repayment and forgiveness options provided by law. We also seek to help borrowers avoid loan delinquency and default, as their punitive consequences for borrowers have not only failed to deter delinquencies but also make it more difficult for borrowers to repay.[4] For example, lower credit scores raise cost-of-living expenses, making it more difficult to prioritize repaying loans. Borrowers who default see their entire unpaid loan balance and any interest owed become immediately due and payable, losing the ability to choose repayment plans with lower monthly payments that may promote financial security and increase loan repayment over time.[5] These consequences would run counter to the

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[1] *See* Memo from Under Secretary Kvaal to Secretary Cardona: Pandemic-Connected Loan Cancellation (Aug. 24, 2022).

[2] *See, e.g.,* https://www.whitehouse.gov/briefing-room/statements-releases/2022/04/06/statement-by-president-biden-extending-the-pause-on-student-loan-repayment-through-august-31st-2022/ ("As part of this transition, the Department of Education will offer additional flexibilities and support for all borrowers.").

[3] *See* https://www.creditkarma.com/about/commentary/cost-of-living-remains-high-as-student-loan-payments-are-set-to-resume-in-2023.

[4] *See, e.g.,* https://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2023/02/at-what-cost-the-impact-of-student-loan-default-on-borrowers.

[5] *See* https://www.aeaweb.org/articles?id=10.1257/app.20200362.

Department's obligations to serve borrowers and taxpayers by collecting student loans through affordable payments.

In sum, the return to repayment after the payment pause is one of the most significant management challenges in FSA's history. And it is not the only one: this year, FSA faces additional management and external challenges that will make this effort even more difficult.

Servicing an Unprecedented Number of Borrowers with Diminished Servicing Capacity

The number of borrowers who will enter or reenter repayment in fall 2023 is more than 20 times greater than the number of borrowers who would typically enter repayment in a single month. It is more than five times greater than the number who typically would enter repayment in a full year. Many of these borrowers are entering repayment for the first time.

FSA and servicer web sites and call centers may be unable to handle the volume of borrowers seeking information, making repayment arrangements, and applying for loan forgiveness. While borrowers' need for support will likely be many times greater than in a typical year, servicers have much diminished call center capacity. They currently have only half as many call center representatives relative to the number of borrowers they serve, compared to 2020, and the representatives are less experienced.

While there is no prior situation exactly comparable to this large-scale return to repayment effort, after the student debt relief announcement, 26 million people either applied or were deemed eligible for relief, and FSA experienced call volumes four times or more than what is typical, leading to significantly longer average monthly hold times and call abandonment rates of more than 50 percent at a time when it had more call center capacity. Debt relief was a simple application with a simple message, implemented when servicers employed far more staff than they do today relative to the number of borrowers they serve, due to subsequent budget reductions.

Transition to New Student Loan Servicers Not Complete Until 2024

FSA is implementing new servicing contracts in the spring of 2024, creating unique transition risks for borrowers. During the pause, the Department transferred or is in the process of transferring 24 million borrowers and hundreds of millions of loans. This includes the exit of two of the largest student loan servicers. New systems to support borrowers seeking public service loan forgiveness and total and permanent disability discharge may not be fully transitioned into service until late 2024.

Loan transfers interrupt borrowers' relationships with servicers, requiring them to establish new accounts, seek information from new sources, and send payments to new destinations. Moreover, they are historically prone to account errors: One study suggested that when borrowers change servicers, as many as one in five borrowers experience problems with inaccurate account information leading to inaccurate payments.[6] Such issues may be particularly challenging and

[6] *See* https://files.consumerfinance.gov/f/201509_cfpb_student-loan-servicing-report.pdf.

time-consuming to correct, as the new servicer may not have ready access to all the necessary information to fix a mistake.

FSA's efforts to hold servicers accountable for performance will also be complicated during this period. For example, one significant incentive for servicer performance is FSA's allocation of future loans, a tool that may provide less of a financial incentive during the transition to the new servicing system that will utilize fewer servicers.

<u>New Income-Driven Repayment Plan Not Fully Implemented until 2024</u>

The Department is finalizing the regulations for a revised IDR plan that will make repaying loans far less expensive than ever before, especially for low- and middle-income borrowers. Borrowers can enroll in the new plan this summer and start to see savings. Effective implementation of this plan – which will not be fully completed until mid-2024 – is complicated and resource-intensive, as is the work needed to educate borrowers about the plan and enroll them. Once enrolled, borrowers are more likely to make monthly payments, and those that remain enrolled are more likely to continue making required payments for years to come.[7]

<u>FSA Is Undertaking Multiple Modernization Projects with Limited Resources</u>

FSA is midstream in a long-planned multi-year modernization effort that includes implementing the congressionally mandated FAFSA simplification and replacing several old critical systems. This includes its central student database, its system for processing FAFSAs, and its system for communicating with colleges and universities. It also plans to upgrade its privacy and cybersecurity standards as it gains greater access to IRS data. Its servicing costs will increase due to the new servicing contracts and the end of the payment pause, as FSA pays servicers more to support borrowers who are currently in repayment. These operational and financial challenges are significantly greater because the Supreme Court did not permit the Department to move forward with one-time debt relief, due to many more borrowers returning to repayment and higher risks of delinquency and default.

In Fiscal Year (FY) 2023, FSA received $620 million less than the President's Budget Request. Without adequate funds, FSA faces challenging decisions about sacrificing key priorities. In FY 2023, FSA had to reduce call center hours and relax metrics for servicer performance to reduce costs, even though borrowers would be better served if student loan servicers expanded hiring and call center hours. It also eliminated other plans to communicate with borrowers about potential benefits. FSA also deployed one-time extraordinary measures to save monthly costs, reduced or eliminated spending on many support contracts, and delayed key developments around product enhancements and servicing. Bringing 28 million borrowers into repayment in this context will preclude FSA from providing the kind of personalized assistance that will be especially critical.

The funding outlook for FY 2024 is uncertain. Without substantially more funding, FSA faces another round of deeper cuts to borrower supports, communications, software development, and

[7] *See* https://www.consumerfinance.gov/about-us/blog/new-report-shows-how-student-loan-borrowers-fare-income-driven-repayment-plans/.

other key areas just as borrowers begin to return to repayment. The complexity of the Federal student loan programs demands individualized attention from borrowers and servicers. Under these circumstances, borrowers may not be able to reach their servicers or receive the personalized attention necessary from servicers to avoid delinquency and default and take advantage of the flexibilities and rights afforded to them by law. Borrowers also may not benefit from the full range of outreach techniques, including postal mail and digital advertising, that FSA had previously planned, because FSA cannot afford to implement those strategies.

The Department is not alone in its concerns about these risks. Associations representing student loan servicers, representatives of borrowers, and Members of Congress have petitioned both Department and congressional leaders for additional flexibility and resources to reach at-risk borrowers, ensure millions of borrowers are enrolled in the right repayment plans, and ensure the accuracy of their account details.

III. Solutions: Transition Process for Return to Repayment

A. Past Actions

In anticipation of restarting loan payments after a lengthy forbearance that risks widespread delinquencies and defaults on federal student loans, the Department has been working for more than two years on a variety of ways to support borrowers before repayment resumes, including:

- Defending its legal authority before the Supreme Court to move forward on our debt relief plan. This plan would have offered relief to more than 40 million Americans to prevent defaults and delinquencies as they restart payments coming out of the pandemic.

- Developing a new IDR plan that will cut costs for borrowers and reduce the crushing burden of student debt for millions of working families. We plan to finalize these rules imminently and allow borrowers to enroll in the plan and begin to save money in summer 2023.

- Identifying 2.2 million borrowers who qualify for forgiveness due to reasons such as public service, disability, or college wrongdoing or abrupt closure.

- Implementing pandemic-related flexibility for servicers and borrowers to help borrowers make the payments that are expected of them, such as by temporarily allowing self-certification of income for repayment plans, extending recertification periods for borrowers already in IDR plans, and giving all borrowers in default the opportunity to return to active repayment.

- Planning and preparing to proactively engage borrowers at high risk of delinquency with high-quality communications from FSA explaining the steps for returning to repayment.

- Coordinating closely with other federal and state agencies to combat scams and fraud.

As discussed in the alternatives considered sections below, these actions collectively are necessary but not sufficient to ensure that the Department and servicers can provide basic service levels.[8]

B. Additional Actions Now Directed

In addition to these steps, based on my authority to place borrowers in administrative forbearance,[9] I am directing FSA to implement and expand its plans[10] to create a transition process to return borrowers to repayment. Specifically, once the payment pause ends pursuant to the Fiscal Responsibility Act, borrowers will once again be legally obligated to make loan payments, will receive bills directing them to make loan payments, and will accrue interest on their loans. Furthermore, borrowers who miss payments will generally no longer be credited with progress toward public-service or income-driven loan forgiveness.

To avoid the worst consequences of delinquency and default, I am directing FSA to provide a 12-month transition period during which no federally managed borrower will become more than 90 days delinquent. Starting after three months and at the end of each month thereafter during the transition period, servicers will apply retroactive forbearances to bring borrowers who are 90 days or more delinquent back into good standing. At the end of the period, servicers will apply a retroactive administrative forbearance to borrowers who missed a payment. The effect of this transition period will be to temporarily delay certain penalties for borrowers who fail to make complete, on-time payments in the first months of repayment. At the same time, interest will continue to accrue on borrowers' loans throughout the transition period, and the grant of retroactive administrative forbearance after periods of nonpayment will not relieve borrowers of the legal obligation to make loan payments going forward.

<u>Use Retroactive Administrative Forbearances to Transition Borrowers to Repayment</u>

To allow for a smooth transition into repayment and to protect borrowers from the worst consequences of non-payment due to servicing risks outside of their control, FSA will place borrowers with federally managed student loans who miss a payment in the 12-months after repayment resumes into a retroactive administrative forbearance to cover periods of missed payments. This retroactive administrative forbearance will not affect a borrower's legal obligation to make payments going forward, and interest will continue to accrue. But it means

[8] Availability of appropriated funds is the driving factor for determining level of service ED and our vendors can provide to borrowers. FSA's administrative funding request for fiscal year 2024 of $2.65 billion is less than two-tenths of one percent of the value of the outstanding loans that it manages, which, at $1.6 trillion, represents a portfolio comparable to those of the nation's largest banks. As noted elsewhere, appropriated funding levels are not assured and resources available for servicing may to continue to decline below pre-pandemic servicing levels.
[9] *See* 34 C.F.R. § 685.205(b) ("In certain circumstances, the Secretary grants forbearance without requiring documentation from the borrower." These circumstances "include but are not limited to" times of transition among repayment and non-repayment statuses.) Forbearances may be granted for a year at a time. *See* 34 C.F.R. § 685.205(c).
[10] In 2021, FSA prepared servicers to apply a retroactive forbearance to accounts on which the borrower misses a payment during the first 90 days after return to repayment.

that borrowers will not reach the point of delinquency that would require negative credit reporting during the transition period.[11]

Specifically, three months after borrowers first return to repayment, servicers will review accounts to identify which borrowers are at least 90 days past due and apply a retroactive forbearance to those three months. That retroactive forbearance will change the credit reporting for those months to "deferred," rather than a delinquent status, and avert the borrower's progression toward default. Three months of non-payment is the point at which the Department reports loans as delinquent to credit bureaus. Applying retroactive administrative forbearance to this period just before credit reporting would be required will avert one of the most harmful initial consequences of delinquency.[12]

Extending the transition process for a year is consistent with borrowers' existing use of forbearances.[13] It will reduce the risks posed by the return to repayment and enable FSA to address the numerous challenges itemized above, including by allowing FSA to complete its transition to new servicing contracts and fully implement the new repayment plan. A one-year term allows servicers to focus on meeting borrowers' needs and responding to their inquiries rather than planning and re-planning operational changes associated with shorter term forbearances.

Upon the expiration of the transition period, the servicer shall add a final forbearance that will bring current all loans that are at least 30 days delinquent (missed a payment). This step will ensure that, at the end of the transition period, no borrower in repayment will be a month or more delinquent, making it easy to communicate consistent expectations to borrowers.

The use of forbearance during this transition period will help smooth the transition to repayment by allowing FSA to target borrowers who miss payments with additional communications and have the capacity to serve them. During this time, FSA and its servicers plan to send informative, targeted communications to borrowers who are at greatest risk of default about opportunities to reduce their monthly payments and achieve long-term repayment success, such as by enrolling in an income-driven repayment plan. FSA's Targeted Early Delinquency Intervention (TEDI) initiative will target borrowers who miss a payment during the first months of repayment, as well as certain borrowers at elevated risk for missing payments, with specific communications about how to get support and to get reengaged with the payment system (for example, informing borrowers about auto-debit, their new servicer, and income-driven repayment plan options). FSA will use evidence from A/B testing (sending different communications to similar borrowers to measure outcomes) generated by this initiative to learn what messages and supports are most effective in reaching these borrowers and improve its messaging throughout this transition period. The transition period will also provide more time to identify and resolve errors arising

[11] Typically, after three months of non-payment, federal student loans are reported to credit bureaus with a delinquent status. Under this policy, after three months of non-payment, the retroactive administrative forbearance would be applied, and those three months would be reported as deferred, which is the status reported for loans in forbearance.

[12] Retroactive application of administrative forbearance is not uncommon within ED's programs. For example, servicers often apply forbearances retroactively for borrowers experiencing financial hardship to cover the past delinquent period.

[13] Forbearances are typically granted for a year at a time. See 34 C.F.R. § 685.205(c).

out of FSA's new processes and system updates, thereby decreasing the likelihood of borrower harm and potential delinquency. Finally, it will allow FSA to implement the new servicing contracts, transition borrowers to their new servicers, and implement the new repayment plan, without putting borrowers at unnecessary and elevated risk of harm.

Collectively these actions will increase the number of borrowers who are able to make their required monthly payments for years to come.

Transition Period Distinguished from the Payment Pause

Unlike the COVID-related payment pause, the transition period is designed to encourage borrowers to make payments if they can afford them. During the transition period, borrowers will be in repayment. Borrowers will be required to make payments, and interest will accrue. They will receive bills, and those bills will show them as delinquent if they do not make required payments. They will suffer consequences if they do not make payments, such as not making progress toward loan forgiveness under Public Service Loan Forgiveness and IDR. However, the application of the administrative forbearance during the transition period will avert the imposition of certain penalties, such as negative credit reporting.[14]

The transition period forbearances will always be retroactive in nature, and borrowers will receive bills, be encouraged to pay, and get delinquency notices if they miss payments. Moreover, during the COVID-related payment pause, even when borrowers did not make payments, their loans were reported to credit bureaus as "current." This included defaulted loans under the Fresh Start initiative.[15] During the transition period, borrowers who do not pay will ultimately be reported as deferred.

Potential Negative Consequences of this Transition

Although borrowers are required to make payments during this period, they will temporarily not be subject to the threat of negative credit reporting. However, nonpayment will result in further interest charges and lengthen the path to forgiveness for borrowers enrolled in IDR and PSLF.[16] In any event, the risk to the Federal loan program is small because any borrowers who fail to make payments will ultimately be subject to enforced collections with additional interest. Additionally, research indicates that many borrowers don't fully understand or are unaware of specific consequences for missing loan payments and are more likely to miss payments when they cannot afford to make them rather than based on any specific conception of the consequences or lack thereof.[17] Therefore, the costs of creating this transition period are likely more theoretical than practical.

[14] The Department is not changing its policy of reporting borrowers as delinquent after three months of late payments. Instead, the forbearance will be applied before credit reporting occurs, and borrowers who are more than 30 days past due (missed a payment) will be reset to current as if they missed no payments. This is similar to the operational process servicers use to effectuate forbearances in other circumstances.

[15] *See* https://studentaid.gov/announcements-events/default-fresh-start.

[16] According to FSA administrative data, millions of borrowers still made payments toward their debts during the payment pause when there were no penalties and few incentives to do so.

[17] *See, e.g.,* https://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2023/02/at-what-cost-the-impact-of-student-loan-default-on-borrowers.

IV. Alternatives Considered

A. Opt-In Forbearances

One alternative would be to remind borrowers that they are entitled to request a forbearance, but not automatically apply these retroactive administrative forbearances to borrowers who have missed payments. Traditional “opt-in” forbearances will continue to be available upon borrower request. However, past experience has shown that opt-in forbearances are ineffective in preventing default. Prior to the payment pause, more than a million borrowers defaulted for the first time every year. And even if opt-in forbearances were effective, during the unique conditions that will obtain this fall, servicers will be unprepared to handle the anticipated volume of forbearance requests. It takes a servicer six to seven minutes to process a forbearance. In the first quarter of 2020, there were 6.2 million borrowers in forbearance and deferment and 7.7 million borrowers in default. If 8 million borrowers call to request opt-in forbearances, FSA estimates that it would require an additional 800 staff members for its call centers to process about 900,000 affirmative forbearance requests per month, which would require nearly a 20 percent increase in current staffing.

B. Individualized Assessment

Manually assessing individual borrowers’ need for forbearance would be even more administratively challenging because it would require some individualized fact-finding and evaluation, which would be practically infeasible for our staff. Depending on how detailed this process would be, it could be substantially more administratively demanding even than the non-feasible opt-in policy addressed above. For example, an Economic Hardship Deferment is a specialized deferment that requires borrowers to submit information about their family size and income. This process is labor intensive for borrowers and takes a servicer about 10 minutes to review and process documentation once submitted by the borrower, in addition to any time spent counseling borrowers about their options or helping them determine how to retrieve the needed information. If 8 million borrowers call to request a process requiring similar individualized review, FSA estimates that it may require closer to an additional 1,000 staff members to carry out these functions Additionally, the individual assessment would create a higher eligibility requirement than is current policy for borrowers to opt-in to a year-long forbearance.

C. Shorter Period with Possible Extensions

I also considered a three-month period for this policy, with possible three-month extensions for up to 12-months. Although such a policy would allow ED to extend based on real-time evidence, the Department already has strong evidence that these problems will persist for far longer than three months and possibly longer than a year, and that servicing problems will not be resolved within shorter periods. Although a shorter term could be extended, given the likelihood of such extensions being necessary, a shorter initial term with extensions would force the agency to expend resources making the same decision multiple times, create implementation costs for servicers, and produce greater confusion among borrowers due the changing deadlines and uncertainty over the likelihood of further extensions, all for no tangible benefit over deciding on the longer period up-front.

V. Conclusion

For all of these reasons, I have concluded that this transition period of 12-months is necessary.