

United States Senate

WASHINGTON, DC 20510

January 23, 2018

The Honorable Betsy DeVos
Secretary of Education
U.S. Department of Education
400 Maryland Ave, S.W.
Washington, D.C. 20202

Dr. A. Wayne Johnson
Chief Operating Officer
Federal Student Aid
U.S. Department of Education
400 Maryland Ave, S.W.
Washington, D.C. 20202

Dear Secretary DeVos and Dr. Johnson:

We write today to express significant concerns about the continued use of private sector collection agencies to pursue student loan borrowers who have fallen behind on their payments, and to obtain more information regarding the purpose of continuing to send taxpayer dollars to these debt collectors. On January 11, the Department awarded new contracts, potentially worth hundreds of millions of dollars, to two private firms. As you consider this massive investment affecting millions of student loan borrowers and their families, the Department should either justify continuing to send taxpayer dollars to these debt collectors or end the use of separately-contracted default servicing.ⁱ

Access to an affordable education is one of the promises of American society. After all, education is more than the mere pursuit of a diploma. It is a transformational experience that empowers individuals to live full lives, both intellectually and economically. As public officials, we should work together to fulfill this vital duty for the people we serve.

Every year, around 1 million borrowers default on approximately \$20 billion in federal student loans. The U.S. Department of Education ("Department") currently outsources responsibility for dealing with defaulted student loan borrowers by contracting with 30 debt collection companies, known as private collection agencies (PCAs). According to the Office of Management and Budget, these debt collectors will receive an estimated \$1.4 billion in taxpayer subsidies in fiscal year 2018.ⁱⁱ

The Department's current system of private contracting overpays debt collectors and allows them to draw down more funds from taxpayers than their expenses. For example, PCAs receive over \$1,700 for each loan rehabilitation, even if the actual agency costs for a particular loan rehabilitation are much lower. The Consumer Financial Protection Bureau (CFPB) estimates that in some cases, the Department pays PCAs nearly \$40 in compensation for every \$1 in cash recovered from certain borrowers through loan rehabilitation.ⁱⁱⁱ Collectors may be receiving hundreds or thousands of dollars for the cost of placing a few phone calls or sending a few emails. Other federal agencies' use of PCAs result in similarly inefficient use of taxpayer

resources. For example, the IRS paid \$20 million to some of the same private collection agencies used by the Department, yet only recovered \$6.7 million in unpaid taxes in 2017, failing to generate net revenues and collecting less than 1 percent of the amount assigned for collection.^{iv}

Further, the current Departmental process provides perverse financial incentives for private collection agencies to aggressively pursue borrowers that no reasonable private sector company would pursue without a government guarantee and encourages distressed borrowers to use less successful tools to help them deal with default.

Because borrowers are required to pay for their own costs of collections, it is almost always profitable for a private agency to keep collecting on small debts—well past the point at which it would continue to collect on non-federal debt. For example, a collection agency could still profitably pursue a \$100 debt because they will receive collection costs on top of the amount owed. Conversely, that same debt on the private market would likely be written off because collection costs exceed what could be repaid. Collection costs consume roughly 20 cents out of every dollar borrowers pay, regardless of whether this amount comes close to the actual cost borne by the debt collector.

A second instance of misplaced incentives comes through pushing borrowers towards less-effective methods of dealing with default. The CFPB Student Loan Ombudsman found that when compared with borrowers who cure default through rehabilitation, “borrowers who cure default through consolidation appear to fare much better, particularly in the first months after exiting default.”^v However, collection agencies receive more than ten times as much to help a borrower enter into a loan rehabilitation than they do to help borrowers consolidate their loans or assist a borrower with loan discharge. This has resulted in about 70 percent of cured defaults being completed through rehabilitation,^{vi} despite the fact that nearly one-in-three of those borrowers defaulted again within 24 months, and more than 40 percent of those borrowers redefaulted within three years.^{vii} Of the borrowers who redefaulted following rehabilitation, more than 75 percent failed to successfully pay even a single bill to their student loan servicer.^{viii} The Department is rewarding these agencies for behaviors that work in opposition to the prospect of student borrower success.

The very goals of private collection agencies are not aligned with the goals of federal student aid programs. The student loan program is designed to help borrowers receive access to credit at terms more favorable than what the private market would otherwise provide. This extends to the repayment process, where struggling borrowers have several options available to reduce or pause repayment. These benefits demonstrate that federal loan repayment is about the long-term success of borrowers, not simply maximizing funds repaid. It is about fulfilling the promise of an affordable education.

To help us better understand whether private collection agencies are providing value to borrowers or taxpayers, please provide a written response to the questions below:

1. What is the per-borrower cost of using private collection agencies, including collection costs paid by borrowers, and how does that compare to the per-borrower cost of the federal student loan servicing companies?

2. What is the average amount of collection costs paid by borrowers in default? Please express this amount both in dollars and as a percentage of the principal balance of a loan.
3. Please provide an analysis showing how the cost of collection activities carried out by the private agencies compares to the compensation paid by the federal government. For instance, how does the typical underlying cost of a collection agency's work behind a loan rehabilitation compare to how much the government pays for a rehabilitated loan?
4. How much would the Department collect through wage garnishment and the Treasury Offset program if it did not contract with private collection agencies?
5. Are there any statutory changes that would have to be made to allow contracted student loan servicers to offer loan rehabilitations, garnish wages, or make use of the Treasury Offset Program?
6. Are there any statutory changes that would have to be made to allow amounts collected through wage garnishment or the Treasury Offset Program to count as payments on an income-driven repayment plan?
7. How does the typical amount paid in collections compare to what that same borrower would have paid on an income-driven repayment plan?
8. Can you please provide a full unredacted copy of the handbook for private collection agencies, including the compensation terms?
9. In its budget documents, the Department reports that the net present value of collections, after accounting for collection costs, is around 77 percent.^{ix} Please provide the underlying data justifying that estimate. Please also provide breakouts of the extent to which those numbers are driven by rehabilitations, consolidations, or other forms of payment.
10. What is the median and average collection rate paid by borrowers? Please break this amount down by the sector attended and outstanding loan balance, as well as borrower characteristics like Pell Grant receipt, dependency status, and race.
11. Please provide more information about the current location of debts in collection, including data at the neighborhood level.

Given the urgency of the situation confronting borrowers who are struggling with student loan debt, we would appreciate your response as soon as possible and no later than February 13. Thank you for your prompt attention to this matter.

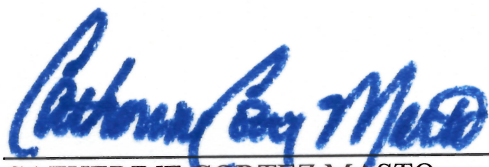
Sincerely,


KAMALA D. HARRIS
United States Senator


PATTY MURRAY
United States Senator


ELIZABETH WARREN
United States Senator


KIRSTEN GILLIBRAND
United States Senator



CATHERINE CORTEZ MASTO
United States Senator



RON WYDEN
United States Senator



MAZIE K. HIRONO
United States Senator



PATRICK LEAHY
United States Senator



SHERROD BROWN
United States Senator



RICHARD BLUMENTHAL
United States Senator



RICHARD J. DURBIN
United States Senator



DIANNE FEINSTEIN
United States Senator

ⁱ U.S. Department of Education. FSA Next Generation Processing and Servicing Environment: Request for Advanced Market Research Information. December 11, 2017.

https://www.fbo.gov/index?s=opportunity&mode=form&id=f1d070c4009577536e646c09689ec152&tab=core&_cv_iew=1

ⁱⁱ White House. President's Budget for Fiscal Year 2018. Appendix, U.S. Department of Education. Page 356:

<https://www.whitehouse.gov/sites/whitehouse.gov/files/omb/budget/fy2018/edu.pdf>

ⁱⁱⁱ Consumer Financial Protection Bureau. "Annual report of the CFPB Student Loan Ombudsman." Oct. 17, 2016.

https://s3.amazonaws.com/files.consumerfinance.gov/f/documents/102016_cfpb_Transmittal_DFA_1035_Student_Loan_Ombudsman_Report.pdf

^{iv} Taxpayer Advocate Service, "2017 Annual Report to Congress", January 10, 2017,

<https://taxpayeradvocate.irs.gov/reports/2017-annual-report-to-congress/most-serious-problems>.

^v Consumer Financial Protection Bureau. "Update from the CFPB Student Loan Ombudsman." May. 16, 2017.

http://files.consumerfinance.gov/f/documents/201705_cfpb_Update-from-Student-Loan-Ombudsman-on-Redefaults.pdf

^{vi} *Id.*

^{vii} *Id.*

^{viii} *Id.*

^{ix} U.S. Department of Education. Fiscal Year 2018 Budget Request: Congressional Justifications. Student Loans. Q-34: <https://www2.ed.gov/about/overview/budget/budget18/justifications/q-sloverview.pdf>