OBAMA-BIDEN TRANSITION PROJECT

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MEMORANDUM

TO: GUARANTY AGENCIES AND NCHELP

FROM: DEANNE LOONIN

RE: REHABILITATION ISSUES

DATE: 12/15/08

Below is a summary of the main problems we consistently encounter with administration of the FFEL rehabilitation program. Although we discussed many of these issues with ASA staff a few weeks ago, we are not singling out a particular agency. In our experience, these problems occur throughout the industry.

We have encountered these problems for years, long before the tightening of the credit market. We hope that you will review this memo and get back to us with responses or comments. Thank you for your consideration.

Key Rehabilitation Issues

1. **Failing to inform borrowers of all options**. We find that in most cases GAs and collection agencies present rehabilitation as the only repayment option for borrowers in default. In fact, borrowers have a legal right to other options as well, including consolidation with Direct Loans. In our experience, the GA and collection agency staffs are too often imposing their own judgments regarding optimal options for borrowers. For example, we repeatedly hear that rehabilitation is preferable because it allows borrowers to clear their credit reports. This is only one factor that may or may not be a borrower's top priority. The borrower should be informed of other options and the pros and cons of each.

   A second reason we hear for pushing rehabilitation is that it is preferable to "dumping" bad loans with the Department. We also hear that the GAs have been pressured by the Department to prioritize rehabilitation over consolidation. This is an issue for policy debate and should not impact a borrower's right to know and exercise her full legal rights.

National Consumer Law Center 7 Winthrop Sq., 4th Floor Boston, Massachusetts 02110
Phone: (617) 542-8010 Fax: (617) 542-8028 consumerlaw@nclc.org http://www.consumerlaw.org

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2. **Assuming a borrower does choose rehabilitation, we frequently encounter problems in the way the program is administered, including:**

a. **Failure to Comply with Reasonable and Affordable Payment Requirements**. The statute clearly states "Neither the guaranty agency nor the Secretary shall demand from a borrower as monthly payment amounts.....more than is reasonable and affordable based upon the borrower's total financial circumstances."[1] The FFEL regulations affirm that the borrower must pay only what is reasonable and affordable.[2] The regulations go even further by prohibiting the imposition of a minimum payment.[3] We understand that documentation is required if the payment is below $50. The problem is not this request for documentation, but the repeated failure to inform borrowers of their right to pay only what is reasonable and affordable. This is compounded further by agencies insisting that borrowers must pay a minimum amount. Agencies appear to derive this minimum amount in different ways, although in many cases borrowers are told that they must pay a certain percentage of the debt owed. As recently as our meeting last month with ASA, we were told that the law requires or at least allows the agencies to require monthly payments based on a percentage of the debt owed. I asked for the statutory or regulatory cite for this provision, but have not heard back.

These practices violate a borrower's right to a reasonable and affordable rehabilitation payment. Informing borrowers that they must pay a minimum amount that is tied to the percentage they owe has nothing to do with what is reasonable and affordable for the borrower. Some GA staff people have told us that this is just the amount they start with. This too is unacceptable. The starting point should be the reasonable and affordable payment amount. To make matters worse, even if the GA staff view the initial amount as a starting point, they generally fail to tell the borrower that she has the right to negotiate a lower payment.

In my many years of representing borrowers, I have never had a case, regardless of the loan holder, where a borrower was correctly informed at the outset that she had the right to pay only what is reasonable and affordable. We can usually get to a correct application of the law, but only through negotiation. This is unacceptable since so few borrowers have advocates to represent them.

b. **Borrowers are not always told of the rehabilitation requirements up-front.** Borrowers are sometimes told about the six month payment plan to renew eligibility, but are not informed how this fits in with rehabilitation. Borrowers should be fully informed of the nine out of ten payment requirement and should

[1] 20 U.S.C. 1078-6(a)(1)(A).
[2] 34 C.F.R. §682.405(b).
[3] 34 C.F.R. §682.405(b)(1)(iii)(B).

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be given a rehabilitation agreement in writing. This should apply to borrowers setting up payment plans in lieu of garnishment or offset as well.

c. **GAs and other loan holders should cease collection efforts during the rehabilitation period as long as the borrower is making payments.**

3. **Sale After Rehabilitation**.

We have heard many different views about the criteria for selling rehabilitated loans. Some GA staff people have told us that a certain minimum monthly payment is required in order to successfully sell the loan. Others say that the loans can be sold regardless of the borrower's payment plan. We understand that the market is volatile and that currently there is little or no market at all for rehabilitated loans. The key question at this point is what will happen to borrowers who have already set up rehabilitation plans and how will new accounts be handled. In these circumstances, it is especially important that borrowers receive information about their right to consolidate with Direct Loans, assuming they are eligible to do so. The GAs should have procedures in place to address these concerns as quickly as possible.

4. Payment Amounts During Transition.

Our clients are consistently told that their payments will likely be higher after a successful rehabilitation. We do not understand the basis for this assertion and are interested in hearing more. Our understanding is that once a borrower successfully rehabilitates a loan, she is then eligible for all of the pre-default repayment options, including the FFEL IBR option once it becomes available in July. It is critical to inform borrowers of these options as soon as possible so that they do not go back into default.

5. Misrepresentations by Collection Agencies.

We find that all of these problems are exacerbated when the information is communicated to borrowers by collection agencies. We also continue to find errors in collection letters, such as letters that have not been updated to change the rehabilitation period from 12 to 9 months.