

## Loan Rehabilitation: A Second Chance for Borrowers

April 2018



### The Distress of Loan Default

**More than 40% of Americans  
with federal student loans  
are behind in their payments  
or aren't making them at all.**

Source: Fortune, 2016



### The Distress of Loan Default

- Unlike other types of installment loans, borrowers have an option to *redeem* themselves if they default on their federal student loans

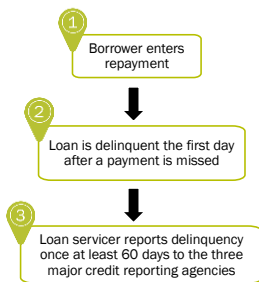


## Agenda

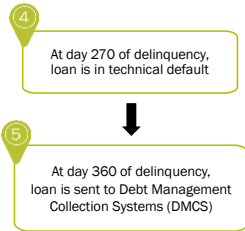
- 1 Share what happens when a loan defaults
- 2 Walk through the nuts and bolts of loan rehabilitation
- 3 Discuss whether loan rehabilitation is the best option
- 4 Share ways you can help your defaulted borrowers
- 5 Provide resources



## The Unfortunate Road to Default



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## The High Cost of Default

Once a borrower defaults, they face numerous consequences

- 1 | Loss of Title IV eligibility
- 2 | Inability to receive a deferment or forbearance
- 3 | Default is reported to the credit report agencies
- 4 | Possible collection costs



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## The High Cost of Default

Once a borrower defaults, they face numerous consequences

- 6 | Department of Treasury may offset federal, state tax refunds, and/or social security benefits
- 7 | May be subject to Administrative Wage Garnishment
- 8 | Department may take legal action



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## Lose Eligibility

- Borrowers will lose eligibility for

  
**Federal  
financial aid**

  
**Deferment**

  
**Forbearance**

  
**Repayment  
plans**




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## Negative Credit History

- Loan default remains on the borrower's credit report for seven years
- Will report as a collection account
- Could impact the borrower's ability to:

  
**Receive loan  
and credit  
card approvals**

  
**Receive lower  
interest rates**

  
**Rent  
apartments**

  
**Secure  
employment**




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## Negative Credit History

<b>GREAT LAKES</b>		
<b>Address:</b> 2401 International Ln Madison, WI 53704 800-xxx-xxxx	<b>Account Number:</b> 44993400611	
<b>Address Identification Number:</b> 7634449213		
<b>Status:</b> Claim filed with federal government		
<b>Date Opened:</b> 06/2010	<b>Type:</b> Education Loan	<b>Credit Limit/Original Amount:</b> \$22,000
<b>Reported Since:</b> 09/2015	<b>Terms:</b> N/A	<b>High Balance:</b> N/A
<b>Date of Status:</b> 01/2016	<b>Monthly Payment:</b> \$0	<b>Recent Balance:</b> \$0
<b>Last Reported:</b> 01/2016	<b>Responsibility:</b> Individual	<b>Recent Payment:</b> \$0

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## Collection Fees

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- Department may charge the borrower a collection fee up to 25% more than the principal and interest

**+25%**



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## Offset Tax Refunds

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- Department can request that Treasury arrange an offset to collect any defaulted student loan debt
- Federal tax refunds payable to joint filing couples are subject to offset
- Federal law requires the Department to give borrowers prior notice of the proposed offset and an opportunity to review loan records



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## Administrative Wage Garnishment

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- Under the Higher Education Act, the Department may require employers deduct 15% of the borrower's disposable pay
- Garnishment may continue until entire loan balance is paid
- AWG is only used for borrowers who refuse to voluntarily repay

**-15%**



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## Legal Action

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- Borrowers who refuse to voluntarily pay may be sued in State or Federal District Court for the outstanding balance plus attorney's fees and court costs



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**Getting Out  
of Default**

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## Loan Rehabilitation

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- Loan Rehabilitation is designed to give borrowers a second chance
  - Once they demonstrate their ability to make monthly payments, the default status is removed from their loan



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## Requirements

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- Borrower must make at least nine full payments over a ten month period
- Payments must be
  - Made voluntarily
  - For the full amount required
  - Received within 20 days of due date; and
  - Reasonable and affordable



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## Requirements

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- Borrowers whose loans are being collected through AWG can enter rehabilitation but they must make five simultaneous payments before AWG will end
  - May suspend AWG while attempting to rehabilitate only once



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## Reasonable and Affordable Payment Standard

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- Borrower's payment must initially be:
  - Amount equal to 15% of amount by which borrower's AGI exceeds 150% of poverty guideline, divided by 12
    - Referred to as 15% formula



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## Reasonable and Affordable Payment Standard

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- Unlike IBR, the borrower does not need to demonstrate a partial financial hardship
- Borrower may provide AGI and family size orally but will need to provide documentation or rehabilitation agreement will become null and void



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## Borrower Objections

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- Borrower may object to payment calculated based on 15% formula
- If they object, ED must recalculate payment based solely on information provided on ED-approved form and, if requested, supporting documentation from borrower and other sources
  - Financial Disclosure for Reasonable and Affordable Rehabilitation Payments form

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## Borrower Objections

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- ED must consider:
  - Borrower's and spouse's current disposable income
  - Family size (as defined in income-based regulations)



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## Borrower Objections

- ED must also consider reasonable and necessary expenses, which include:
  - Food
  - Housing
  - Utilities
  - Basic communication expenses
  - Necessary medical and dental costs
  - Necessary insurance costs
  - Transportation costs
  - Dependent care and other work-related expenses
  - Legally required child and spousal support
  - Other title IV and non-title IV student loan payments
  - Other expenses approved by ED



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## Completion of Loan Rehabilitation

- Once borrower has made required payments:
  - ✓ Direct loans will be returned to loan servicing
  - ✓ FFELP loans will be purchased by eligible lender
  - ✓ They can chose a repayment plan (unless they had one with DMCS)



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## Completion of Loan Rehabilitation

- Once borrower has made required payments:
  - ✓ Title IV eligibility will be restored
  - ✓ The loan will no longer be in default
  - ✓ The default status will be removed from their credit report
  - ✓ Tax offset will end
- Borrowers are only able to complete rehabilitation once



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**Is Loan Rehabilitation the Best Option?**

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**Second Chance Options for Borrowers**

**Loan Rehabilitation**

**Direct Consolidation Loan**

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**Rehabilitation vs. Consolidation**

	Loan Rehabilitation	Direct Consolidation
Payment arrangement required	Yes	Yes
Title IV eligibility restored	Yes	Yes
Tax offset stopped	Yes	Yes
AWG stopped	Yes	Yes
Default status removed	Yes	Yes
Default notation from credit report removed	Yes	No
History of delinquency from credit report removed	No	No

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## Helping Your Defaulted Borrowers

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### Benefits of Outreach

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- By educating your defaulted borrowers on their options it could:
  - Help them restore their credit
  - Give them an opportunity to return to school and receive federal financial aid
  - Enable them to apply for an FHA or VA loan
  - Possibly stops wage garnishments and tax offset



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### Benefits of Outreach

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- By educating your defaulted borrowers on their options it could also help lower your cohort default rate
  - If the borrower rehabilitates the loan before the end of the cohort default period, the borrower is not included in the numerator because the borrower is no longer considered to be in default



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## Cohort Default Rate

The **Numerator** is the number of Stafford loan borrowers from the denominator who default within a cohort period



The **Denominator** is the number of Stafford loan borrowers who enter repayment within a fiscal year



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## What is a Cohort Default Period?

### FY 2017 CDR

Borrowers who entered repayment between 10/01/2016 and 9/30/2017 and who defaulted between 10/01/2016 and 9/30/2019

### FY 2018 CDR

Borrowers who entered repayment between 10/01/2017 and 9/30/2018 and who defaulted between 10/01/2017 and 9/30/2020

Borrowers who entered repayment between 10/01/2016 and 9/30/2017

Borrowers who entered repayment between 10/01/2017 and 9/30/2018



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## Outreach Strategies

- Send letters to defaulted borrowers to include:

Details of loan rehabilitation and consolidation

Benefits of resolving default

Contact of where to go for help



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## Outreach Strategies

- Get the borrower's attention
  - Highlight what you want them to know most in **bold** or **color**
  - Sign letters by hand
  - Colored envelopes
  - School's logo or mascot
  - Hand write envelopes
  - Use stamps



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## Conclusion and Resources

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## Conclusion

- Implement effective default prevention measures to facilitate successful repayment
- Reach out to defaulted borrowers to let them know how to resolve default



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