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SOME COLLEGES TRY TO BURNISH STUDENT-LOAN DEFAULT RATES

Some borrowers are encouraged to seek 'forbearance,' and thus aren't considered in default

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Some U.S. colleges and universities are inappropriately urging alumni to postpone payments on their student loans, causing their balances to rise while allowing the schools to skirt regulatory oversight, a government watchdog reported Thursday.

The practice is one reason why some borrowers' balances are rising and so few schools are sanctioned for leaving students in excessive debt, according to the Government Accountability Office report, released by Democrats on the House education committee.

The report examines a decades-old law that assigns each college a "cohort default rate." The law is designed to punish a college if a large share of its students default within three years of graduating or dropping out. Ultimately, if a high rate persists, the school is barred from collecting any federal loan or grant dollars from new students, the schools' main source of revenue.

The law is the government's main tool for cracking down on schools that leave Americans overly indebted and with weak job prospects. The Education Department sanctioned as many 1,000 schools during one year in the 1990s but in the 2000s has punished few, if any, year to year. Last year it sanctioned 11, the GAO report shows.

The GAO report highlights how schools have hired companies known as default-management consultants to help reduce their cohort default rates. The consultants are urging many students to seek "forbearance," in which the government allows them to suspend payments for a period, in many cases 18 months, the GAO says.

Students in forbearance aren't considered in default even though they pay nothing toward their balances. But many of them default later on, after the forbearance period ends, the GAO says. Those defaults don't count against a school in its default-rate calculation because they occur outside the three-year window.

Some schools and student advocates say forbearance is a good option for the most desperate borrowers, such as those who are unemployed. But the GAO report suggests the option is overused – many borrowers who receive it have the means to pay something toward their debt – and will have negative consequences in the long term.

"While forbearance can help borrowers avoid default in the short term, it increases their costs over time and reduces the usefulness of the 3-year default rate as a tool to hold schools accountable," the GAO report states.

A typical borrower leaving school with $30,000 in debt would pay an additional $6,742 in interest after three years of forbearance, as opposed to paying down the debt from the start, the report found.

The GAO report looked at nine default-management consultants – which it doesn't name – used by colleges. It said four of them sent borrowers unsolicited letters containing only forbearance applications and presenting students no other options, such as plans that set monthly payments as a share of their incomes.

Terry Hartle of the American Council on Education, the biggest trade group for college and universities, said a limited number of schools may be acting in the manner laid out in the study, namely those most desperate to lower their default rates.

The consultants "probably use a range of different techniques. I suspect some firms are willing to use techniques that may or may not be in the best interest of the students. I certainly don't think that the case for all of them," Mr. Hartle said.

One default-management consultant, the report found, inaccurately told borrowers they could lose access to federal assistance programs such as supplemental security income or food stamps if they defaulted on their loans.

Eight consultants didn't have any contracts with schools looking to help borrowers who were past due on their loans after the three-year cutoff mark, the GAO says.

Entering forbearance involves fewer hurdles compared with other repayment options. Borrowers can request the option over the phone, while students seeking to be placed in an income-based plan must submit a written application that can take a couple of weeks.

The study recommends that Congress strengthen oversight by changing the law so students in forbearance are taken into account when the government calculates a school's default rate.