Consumer Finance Monitor (Season 5, Episode 22): An Update on the Debate Over Federal Student Loan Forgiveness

Speakers: Alan Kaplinsky and Tom Burke

Alan Kaplinsky:

Welcome to Consumer Finance Monitor podcast, a show in which we explore important developments in the world of consumer finance. I'm Alan Kaplinsky, the former chair of our consumer financial services group and I'm now senior council at Ballard Spahr. So today we're going to address a very timely topic, something that's in the news all the time and it's literally been in the news now throughout the entire Biden administration. We want to revisit it because things seem to be coming to a head. I'm really delighted to have on our program today, Tom Burke.

Alan Kaplinsky:

Tom did a podcast with us in May about a year ago, actually and a lot of water has gone over the dam since that time. I thought it was important to bring Tom back so that we could bring everybody up to date on this extremely important subject. First of all, let me introduce Tom. He is a partner in Ballard Spahr's Philadelphia office, where he is a member of the firm's white collar and consumer financial services groups. He litigates student lending matters across the country on behalf of lenders, guarantors, and loan servicers. He's represented clients in major enforcement actions, class actions, and other prominent student loan litigation. He regularly advises clients on related regulatory issues and state licensing. So before we get into it, Tom, a very warm welcome to our show.

Tom Burke:

Alan, I'm so happy to be here. Thank you very much for the introduction.

Alan Kaplinsky:

My pleasure. So we last spoke about the topic of student loan forgiveness about a year ago, as I mentioned. We've gotten to hear a lot more about this in the media over the last few months. Can you tell us what's happened since the last time we spoke?

Tom Burke:

Absolutely. It's been quite a lot. The context in which student loan forgiveness is being discussed has changed substantially since that time. So I'm sure you'll remember that back in March, 2020, Congress imposed a freeze on student loan payments and temporarily set interest on those federal student loans to 0%, which had the effect of locking in all 43 million federal student borrowers in the same place they were at the beginning of the pandemic. The Trump administration extended that pause twice, and the Biden administration since then has extended it another four times most recently until August 31st. So in the view of some, this has created whiplash for student borrowers in the sense that each time the U.S. Department of Education is saying, "This is the last time we're going to pause these payments, get ready to start honing up again on a monthly basis." Then the deadline comes up and it gets extended again.

Alan Kaplinsky:

Yeah, just by way of clarification for our audience, Tom, we're talking about federal student loans. We're not addressing private student loans.

Tom Burke:

That's exactly right. There are two real types of federal student loans, direct loans, which are those that are actually made by the federal government, although they're typically serviced by private companies and then what they call FFEL loans, which were the prior flavor of the 1990s and for a few decades afterward, in which private lenders issue loans, but those are guaranteed by the federal government and we call all of those federal loans for these purposes.

Alan Kaplinsky:

Okay, okay. So I did interrupt you while you were completing a thought, I think.

Tom Burke:

Sure. So I was just noting that you have this huge population of student borrowers who collectively owe about 1.6 trillion dollars and the status quo has become a scenario where they are not making any payments on those loans. In fact, the balance is increasing, not because of interest, but because you have new student borrowers every month who are graduating and entering repayment, but they're not actually entering repayment in the sense that they have to do anything yet. So that has led to continuing pressure from progressive groups in particular, to say, "Let's go ahead and just forgive that debt. Nobody's been paying it for two years anyway. Why not just wipe it off the books?"

Alan Kaplinsky:

So what has changed over the last year that might explain the apparent change in the Biden administration's willingness to consider broader forgiveness? Because I know really since the beginning of the Biden administration, he seemed to be opposed to blanket forgiveness.

Tom Burke:

That's exactly right. So the Biden administration for years, including during his campaigning, has been saying that it has to be Congress that takes that step and makes that decision to forgive any amount of federal student loans, really. Biden himself has said, "I don't think I have the power to do it." Over the last few weeks, that tone has changed. There are several potential contributors and we'll get around to exactly what president Biden is proposing a little bit later, but he came into office with approval ratings in the mid to low fifties, right? Which signals fairly strong public support for his agenda. It's what Barack Obama enjoyed for some of his term. Between July and October last year, those numbers tanked down to the low forties, which is where they've hovered since then.

Tom Burke:

Now that's not unprecedented. It's where president Trump's approval ratings were for most of his presidency, but there's an increasing sense that these poll numbers, combined with the threat of persistently high inflation, could lead to a very bad result for Democrats in this year's midterm elections unless they can find a way to stem the tide. So one way to do that, the thinking goes, is to show that the president can still go big even without help from a deadlocked Congress. When you think about it, there's no real bigger way to go big than to wipe away some huge chunk of this 1.6 trillion dollar debt.

Alan Kaplinsky:

Wow. So what's the... Since he's thinking of making a change and you've speculated that there might be a political motivation in mind, particularly with the midterms coming up around the corner, but what is actually the public's general thought about loan forgiveness? I know just anecdotally, I was talking to my daughter-in-law over the weekend and she, before the pandemic paid back, all her student loans. She took everything, probably her entire net worth, paid it all back. She is really resentful now that if she hadn't paid, she could get a clean slate and without any black mark on her credit record.

Tom Burke:

Alan, that's exactly right and it illustrates one of the divergent viewpoints on this. So there's been a fair bit of polling on this, including recently as of April. As you might expect, if you ask student borrowers who have not yet repaid their loans, whether their debt should be forgiven, the answer is a resounding yes. Likewise, if you said, "Tom, would you like to not make your mortgage payment next month?" I would probably say, "Sure, let's go ahead and forgive that debt." But in particular, when you actually take a broad spectrum sample here, only 19% of respondents in the latest survey wanted to cancel all federal student loans for all student borrowers. 74% of respondents did not support forgive everything for everyone, but a much larger percentage, 64% support at least some debt cancellation for some borrowers. You have about 30% who say that no student loans should be forgiven under any circumstances. So I don't know what your next question here will be, but I would like the chance to say something about what is driving or motivating the anti-forgiveness group. And you've already touched on that.

Alan Kaplinsky:

Yeah. Well, yeah, go ahead. What do you think?

Tom Burke:

So this seems to provoke strong reactions. You've seen some of it on the op-ed page in the New York Times or the Wall Street Journal probably. Some people have a concern that this is a handout to college graduates at the expense of people who didn't go to college and that it's actually a very regressive type of forgiveness because it is not in some cases, the neediest who would be helped by this, it's people who have college degrees. Some people are upset that this would clearly favor borrowers who carried their debt instead of people who paid up front, or who worked through college, or made that decision to pay it down early. There's a large group of economists who thinks that forgive the debt will worsen the current inflationary pressure, because it will have the effect of increase in consumer spending. Somebody used to have a $100,000 debt and maybe they're saving money because of that. If that debt is gone, then they're going to spend that money and that's going to contribute to the inflationary cycle as the reasoning goes.

Tom Burke:

Then last, what I think is probably the most persuasive sentiment on this is that, the underlying issue with what people call the student debt crisis, the reason the overall number of the federal student debt portfolio has increased so much over the last 15 years, and even going back 30 years, the issue is that tuition costs keep going up and federal money remains available to whoever wants to borrow it. So there's a perception that even if you forgave all the student debt today, tomorrow, that treadmill would just start up again, because none of the colleges are going to decrease the tuition and in fact they might increase it. So there's a real sense that the underlying problem, which is the cost of tuition, combined with the ability to borrow as much money as you need to pay that tuition, is going to still be there.

Alan Kaplinsky:

Well, what about the servicers of the federal student loan debt? They get compensated, right, for servicing the loans on behalf of the federal government? I assume they want this to start up again, right? They don't want to forgive.

Tom Burke:

Well, so I won't purport to speak on behalf of the whole industry of servicers, and I think it's actually a nuanced view here. Most of the industry participants that I've spoken to favor a dramatic reduction in what I'll call the programmatic or regulatory complexity in this space. Right now, you have literally dozens of types of forbearances or deferments that are available. You have things like interest capitalization events that have tremendous financial consequences, but are not intuitive to a lot of borrowers and servicers have to explain all this to borrowers.

Tom Burke:

So in my view, happy borrowers make for happy servicers, and so the servicing view is, let's simplify these programs. Let's give borrowers a smaller range of easier to understand options that offer the same or better benefits than what exists now, and you know what? Maybe let's go ahead and proceed with forgiving some particular tranches of people who are in the most distress. But at the same time, I think it's correct to say that servicers don't like the idea of their entire business model drying up tomorrow. I mean, that would be the same of any industry that you were considering wiping out a large scale portion of the debt at one time.

Alan Kaplinsky:

Yeah, sure. Has anything changed in the course of the past year, Tom, with respect to the authority of the president to wipe out the student debt? You've said that president Biden said from the very beginning that he lacked the authority, only Congress could do it. What's changed, if anything?

Tom Burke:

Nothing on that question has changed, which is what makes this a very interesting dynamic. The case for the president's power to forgive any very large volume of federal student loans all at the same time by executive action, the case for that remains in my view and the view of many others, tenuous. Proponents of loan forgiveness have pointed to the Higher Education Act and the HEROES Act as a way that the president could direct the Secretary of Education to forgive these loans. It's a very nuanced argument that depends a lot on the exact text, but I'll break it down.

Tom Burke:

Under the higher education act, the Secretary of Education has the authority to modify student loans under some circumstances. The question that I think will ultimately reach the Supreme Court if this were to happen, is whether zapping a loan's principle balance from $100,000 to $0 can be fairly described as modifying that loan or whether that's really some other verb such as to forgive, or to cancel, write off, write down that debt. Congress has given the Secretary of Education the authority to cancel debt or forgive debt under some circumstances, but it's usually very narrowly prescribed. It's not the idea that you could just forgive 1.6 trillion dollars in one fell swoop.

Alan Kaplinsky:

Has the Secretary of Education taken a position?

Tom Burke:

The surprising answer is that we don't really know. So the Secretary of Education, Dr. Miguel Cardona, at the president's order has received a memo on this topic and we don't know what the memo says. So to provide some context for that, the event that prompted a lot of this discussion was Senator Elizabeth Warren releasing a memo about two years ago while she was on the campaign trail saying that the president has the authority to do this. Not too long thereafter, the Trump Department of Education issued its own memo saying that the president does not have the authority to do this. Also recently, we saw a memo written by a prominent former democratic Department of Education lawyer named Charlie Rose, which also said that the president probably does not have the authority. Nancy Pelosi has said that she does not think the president has the authority.

Tom Burke:

So the tantalizing thing, which I've been winding up to here is that president Biden commissioned his own memo on the subject from the Department of Education, and that memo has been released to the public only in heavily redacted form. So we don't know what conclusion they reached. We know it's a long memo, it was carefully considered, and no one knows whether it is a yes or a no. There's also a lot of speculation about why the president doesn't want to release it. Is he worried that if the conclusion is he does have the authority, that he won't be able to escape the pressure from the left to actually use it? Or is he worried that if it says no, then obviously his hands are somewhat tied as to actually doing it?

Alan Kaplinsky:

Yeah. So do we know, although the president seems to at least so far, shown a reluctance to forgive the student debt in its entirety, is he willing to modify it in some fashion by providing some type of credit against the principal balance?

Tom Burke:

Yes.

Alan Kaplinsky:

He would have the authority to do that, I take it?

Tom Burke:

Well, we don't know. It depends on how big he goes. So the answer is that Elizabeth Warren started this by pushing for complete forgiveness of all federal student loans. President Biden said, "I would like a lower number, $10,000 per borrower maybe if Congress authorizes it." More recently, he's come back around to that idea of $10,000 per borrower. That of course sounds like a much smaller number. If you do the math, it still comes out to probably around 200 billion dollars, which is, I think we can all agree, a fairly large amount to resolve through executive action. But the point is, anytime the president considers modifying millions of student loans at one time to the tune of hundreds of billions of dollars, there's going to be concern about whether he actually has the authority to do that. So I think even a narrower forgiveness event like that could prompt challenges.

Tom Burke:

There's some questions about who actually has the standing to bring that challenge, which I'd be happy to talk about. There are other ways he could tune that proposal to make the impact less regressive as well. So for instance, I'll keep going about what the president has discussed here. He's mentioned the possibility that he might cap it at individuals earning $125,000 or less per year, and the theory is that would avoid what you would call regressive impact of forgiveness on a lot of higher earning doctors and lawyers who happen to pile up a lot of Ivy League debt or grad school debt while they're actually not in any financial distress. In the same manner, Biden might limit this forgiveness only to undergraduate loans, and again, avoid paying for the doctors or lawyers. I'm sure all those folks with the graduate degree, in some other humanities subject that is not as lucrative won't want to hear that, but that is a proposal that I understand is under consideration.

Alan Kaplinsky:

Got it. So has the Department of Education been doing anything else that looks like baby steps toward full loan forgiveness?

Tom Burke:

Yes. So over the last year, really since Rich Cordray, who of course is a well known figure in our circles, became the chief operating officer of the office of federal student aid. The Department has taken some big steps toward loan forgiveness on a much more targeted basis. A few of these things are important, both for us to talk about as lawyers and for people out there listening to know about, the department has recently launched two major time limited initiatives to streamline major federal student lending programs. So specifically on the one hand, you have public service loan forgiveness, which I think probably everyone has seen in the headlines by now and on the other, you have income driven repayment. The conversation around both of those has been that they are very complex. They are very complex regulatory frameworks that resulted in many borrowers not being able to take full advantage of those programs, and that by using the authority under the HEROES Act related to the pandemic, the Department can temporarily cut through the red tape.

Tom Burke:

So let me give you an example. The public service loan forgiveness program previously was limited only to payments made on direct loans, not those FFELP program loans that a lot of other borrowers still had. Now the Department is saying, "Well, if you consolidate those loans into direct loans, we will count all of the previous payments, not forever, but for now, if you do it by October." So they're finding ways to give a lot more people credit under those programs than they otherwise would have. Those are not tiny steps. We're talking about billions of dollars of forgiveness for people who need it. People who have either very low incomes, people who are spending that time in public service, and these are probably going to be effective strategies for targeting the populations that need help with their loan payments.

Alan Kaplinsky:

Right, right, right. So, Tom, what is the industry view on all this? By that I mean the lenders, the guarantors, the servicers, we talked a little bit about the servicers already.

Tom Burke:

Well, many of the industry participants, again, the ones that I've spoken to, are looking for ways to solve the underlying problems that have led to a lot of the challenges that student borrowers are facing, which are namely, eliminating regulatory complexity, maybe collapsing the number of income driven repayment plans down to one plan instead of five plans, maybe eliminating the numbers of forbearances and deferments, eliminating things like interest capitalization events that can drive up borrowers balances in unexpected ways. In other words, make the servicing a lot more like servicing of static loan types like mortgage or auto loans often tend to be so that you don't need to give a borrower a 10 minute explanation of interest capitalization in order to help them be informed enough to make decisions about how they want to repay their loans. So in other words, let's make it more administrable, let's find a way to keep borrowers in active repayment instead of being on the sidelines with deferments or forbearances, and let's make this whole process simpler.

Alan Kaplinsky:

Right. So where do we go from here?

Tom Burke:

The Biden administration is likely to announce something on this very soon. I have no reason to think it's going to be tomorrow, but I do think it will be within the next couple weeks or months. That's because they want to do something that they can both announce and probably start to implement before the midterm elections. Again, I don't mean to suggest that this is purely politically driven, but I think there is an effort to show progress before those elections happen. Now, whether that actually does anything will depend on whether there are any immediate legal challenges to that action. If the president were to go too big with this, it's going to increase the possibility of a really slow onerous and probably meritorious challenge to his ability to do that. Whereas if he goes with something targeted, maybe he can get by without a challenge, maybe it'll stick and it could happen soon.

Alan Kaplinsky:

I see. Now, let's look at the other side of the coin. Assume he does nothing, and I think you mentioned that the existing moratorium on repayment, non-accrual of interest extends, I think you said through the end of August, if I got that right. What do you think will happen? Do you think it'll get extended, extended, and he'll kick the can down the road indefinitely? I think there's probably a very justifiable fear that if they all of a sudden end the moratorium, there are going to be, the defaults are going to be through the roof and a lot of people are going to be in very difficult financial trouble.

Tom Burke:

That's exactly right. There is a real concern that that moment, that first month, when they put borrowers back in repayment, there'll be people who don't know that they're back in repayment and there'll be people that are not ready to back in repayment, and there also, and when I say they, I mean the Department of Education, I think they're concerned that the federal student loan servicer lineup, which you may know has changed, especially over the past six months, they need to have those contractors ready to do the work. I think the contractors of course, will be ready to do the work, but they need to make sure there are no administrative hiccups as that turnover happens. So my personal guess is that we would be likely to see another delay, another extension on that payment pause probably through the end of the year, and then come 2023, people will be in a position to reassess whether it makes sense, whether we're past enough of the pandemic related slow down, that people can start making those payments again.

Alan Kaplinsky:

Yeah. I mean, the irony here is that the economy recovered after the pandemic, but because of inflation, a lot of people think we're headed to a recession. So this gets extended through the end of the year, we might be in a recession at that time and that's going to be a very difficult time to require people to start repaying again.

Tom Burke:

That's right. I'll note though, that the interesting fact about this repayment situation is that most federal borrowers have access to these income driven repayment plans I mentioned earlier, which cap the payments due as a portion of the borrower's discretionary income. So even if you are in dire straits with respect to your employment picture, currently even under existing law, options exist for you to be paying $0 a month in some cases, even without the payment pause and even without any other help. Now you will be accruing interest on your unpaid balance during that time, but that's always been true and the way the federal program accounts for that is that all of these income driven repayment plans have loan forgiveness built into them. This is not a secret, but it's something that's not discussed very much. All of the income driven repayment plans, which currently I think nine million borrowers are enrolled in, allow for forgiveness after 20 to 25 years of repayment and you can be paying $0 a month that entire time.

Tom Burke:

So long as you stay in an, what they call an IDR plan, eventually you'll get to a point where those loans will be forgiven. Now, there are two wrinkles on that. The first is that, that could be a taxable event. So even if you were a person of limited means, you could end up with a tax bill of hundreds of thousands of dollars if your loans were abruptly forgiven in one fell swoop. Now Congress stepped in and actually paused that. They wrote a provision into one of the pandemic bills that provided that no forgiveness events would be taxable for the next five years. I think this was Elizabeth Warren playing the long game and saying, "If we do get that loan forgiveness, we want to make sure that people are not going to be hit with a tax bomb on the back end of it."

Tom Burke:

Then the other interesting point that I'll just make about these IDR plans is that, a lot of borrowers are optically confused by the fact that they are, in their view, making payments on their loans, but the balances continue to go up and you hear a lot of people say, "How can I have been making payments for 10 years on my loans and I still owe more than when I started 10 years ago?" The answer to that is simply that, by the very nature of these IDR plants, if the federal government allows you to pay less on a monthly basis than the interest that is accruing on your loans, then of course you will owe more money as that happens. That's why that possibility of loan forgiveness is necessarily baked into that plan. Because if you didn't, right, you would have people coming out of their IDR period, owing hundreds of thousands of dollars that they could never possibly repay.

Alan Kaplinsky:

Right, right, right. Okay. Well, Tom, we're getting toward the end of our show today, but before we wrap things up, I'm wondering if there is anything that we've overlooked or in questioning you, I have neglected to raise with you that is germane here?

Tom Burke:

Well, there's one lawyerly note that I'll add. When we were talking about the possible bases for the president's authority to direct the Secretary of Education to forgive these loans, I mentioned the Higher Education Act, which contains that modification language we talked about. What I did not mention was actually the more likely source or an equally likely source of authority, which is the HEROES Act, and it's not the bill that Democrats tried to push through at the beginning of the pandemic. It's actually from early in the 2000s, not long after 9/11. That HEROES Act gave the Secretary of Education, the authority to cancel loans in response to extraordinary circumstances faced by borrowers.

Tom Burke:

This was not a controversial thing when it happened. It seemed like they had the idea that if someone's house gets destroyed by hurricane Katrina, that you can make a very individualized determination and say, "That person's not going to be able to repay their loans." What that Act, I think, does not do is say that you can look at a portfolio of a million people, or 10 million people. Or 40 million people and say that all of them are entitled to that debt relief regardless of their circumstances. So I'm very interested to see how this plays out as the actual legal analysis. If it proceeds, if there's a challenge where somebody has standing and how those arguments develop.

Alan Kaplinsky:

Well, Tom, thank you very much for joining us today. I also want to thank all of our listeners for downloading the show today. I want to remind all of our listeners that our show is weekly, and generally we release a new show every Thursday. I couldn't let the show go by today without tooting the show's horn, because last year, a law consulting website called Good2BSocial selected our podcast show as the second best podcast show of major law firms of the top 200 law firms. We are extremely proud of that achievement. So with that, Tom, again, thank you for being on the show and we're done for today. Hope everybody enjoys the rest of their day.