# EXAMINING THE MISMANAGEMENT OF THE STUDENT LOAN REHABILITATION PROCESS

## HEARING

BEFORE THE

SUBCOMMITTEE ON HIGHER EDUCATION
AND WORKFORCE TRAINING

COMMITTEE ON EDUCATION
AND THE WORKFORCE

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED THIRTEENTH CONGRESS

SECOND SESSION

HEARING HELD IN WASHINGTON, DC, MARCH 12, 2014

**Serial No. 113–50**

Printed for the use of the Committee on Education and the Workforce

Available via the World Wide Web: *www.gpo.gov/fdsys/browse/committee.action?chamber=house&committee=education*
or
Committee address: *http://edworkforce.house.gov*

U.S. GOVERNMENT PUBLISHING OFFICE

86–974 PDF WASHINGTON : 2015

For sale by the Superintendent of Documents, U.S. Government Publishing Office
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# C O N T E N T S

# EXAMINING THE MISMANAGEMENT OF THE STUDENT LOAN REHABILITATION PROCESS

**Wednesday, March 12, 2014**
**House of Representatives,**
**Subcommittee on Higher Education and Workforce Training,**
**Committee on Education and the Workforce,**
**Washington, D.C.**

The subcommittee met, pursuant to call, at 2:32 p.m., in Room 2175, Rayburn House Office Building, Hon. Virginia Foxx [chairwoman of the subcommittee] presiding.

Present: Representatives Foxx, Petri, Walberg, Hinojosa, Tierney, Bishop, Bonamici, and Loebsack.

Also present: Representative Kline.

Staff present: Janelle Belland, Coalitions and Member Services Coordinator; Amy Raaf Jones, Deputy Director of Education and Human Services Policy; Nancy Locke, Chief Clerk; Brian Melnyk, Professional Staff Member; Daniel Murner, Press Assistant; Krisann Pearce, General Counsel; Jenny Prescott, Legislative Assistant; Mandy Schaumburg, Senior Education Counsel; Emily Slack, Professional Staff Member; Alex Sollberger, Communications Director; Alissa Strawcutter, Deputy Clerk; Tylease Alli, Minority Clerk/Intern and Fellow Coordinator; Kelly Broughan, Minority Education Policy Associate; Eamonn Collins, Minority Fellow, Education; Jamie Fasteau, Minority Director of Education Policy; Rich Williams, Minority Education Policy Advisor; and Michael Zola, Minority Deputy Staff Director.

Chairwoman FOXX. A quorum being present, the subcommittee will come to order.

Good afternoon and welcome. I thank our panel of witnesses for joining us today to examine the Department of Education's management of the student loan rehabilitation process. Prior to 2010, the federal government authorized two loan programs through the Higher Education Act to help students and their families pay for college. As part of the health care overhaul in 2010, the Democrat-led Congress eliminated the Federal Family Education Loan Program, which offered student loans through private lenders, and shifted to 100 percent direct lending.

The federal government now originates and oversees every single federal student loan issued. However, we aren't here today to debate the merits of private lending or federal lending. We are here to review whether the department is equipped to handle the enormous task it has taken on. In particular, a significant number of borrowers have raised concerns about the department's inability to manage the critical loan rehabilitation process. In short, loan rehabilitation provides borrowers a one-time opportunity to get out of default. Once a borrower makes nine on-time monthly payments over a 10-month period, the loan returns to good standing, the default is removed from the borrower's credit report, and eligibility for repayment options or additional financial aid are restored.

Ensuring the rehabilitation process is working in a timely and effective manner is critical to the well-being of the nation's borrowers. Defaulting on student loans has serious consequences for a borrower's credit rating, making it more difficult to obtain affordable credit, secure a job, or take out a mortgage. In an effort to understand better the problems plaguing the direct loan system, the committee began conducting oversight and soliciting feedback from borrowers. The committee discovered widespread issues in the department's management of the loan rehabilitation process, including security breaches, inaccurate reporting of payment statuses and loan delinquencies, and delays in accessing the department's default loan management website.

For example, one borrower claimed to have made the required amount of on-time payments in an effort to rehabilitate his loan, but, due to the department's delays, was unable to remove the black mark of default from his credit report to take advantage of better repayment options. Another borrower told the Chronicle of Higher Education she started a second job to cover the 1,350 monthly payment on her defaulted loan. But once she finally made her ninth payment in October 2011, she was informed the department was unable to update her loan status due to problems with the loan management system.

With thousands of borrowers stuck in financial limbo, Senate and House Republicans asked the Government Accountability Office to conduct a detailed review of the Department of Education's capacity to move loans through the rehabilitation process. According to the final report released today, the GAO found the department lacked appropriate monitoring over the upgrading of the default management system. Further, not a single loan rehabilitation was processed from September 2011 through March 2012, affecting approximately 80,000 borrowers.

Additionally, the report sheds light on weaknesses within the department that raise questions about the department's ability to manage the direct loan program itself. When attempting to upgrade its default loan management system, the department failed to oversee the system upgrade effectively or prepare for any associated risk. The department also failed to monitor complaints from borrowers or ensure resolution of these issues. And although the department has claimed any issues are resolved and borrowers are able to rehabilitate their loans, we will learn today that the resolutions put in place are workarounds and not permanent solutions.

Policymakers have a serious responsibility to ensure student loans increase opportunity, not limit future success. I look forward to continuing our oversight efforts today as we work to strengthen the federal student loan system and protect student borrowers.

I now yield to my distinguished colleague, the senior Democrat member of the Higher Education and Workforce Training Subcommittee, Mr. Rubén Hinojosa, for his opening remarks.

[The statement of Chairwoman Foxx follows:]

Prior to 2010 the federal government authorized two loan programs through the Higher Education Act to help students and their families pay for college. As part of the health care overhaul in 2010, the Democrat-led Congress eliminated the Federal Family Education Loan program, which offered student loans through private lenders, and shifted to 100 percent Direct Lending.

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Policymakers have a serious responsibility to ensure student loans increase opportunity, not limit future success. I look forward to continuing our oversight efforts today as we work to strengthen the federal student loan system and protect student borrowers.

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Mr. HINOJOSA. Thank you, Chairwoman Foxx.

Today's hearing will focus on student loan rehabilitation and the steps that the U.S. Department of Education has taken to strengthen that process. I want to thank our distinguished panel of witnesses for joining us this afternoon to provide some context for this discussion, and to share their views on how the federal government can continue to best serve student borrowers. Let me begin by saying that the U.S. Department of Education must do all it can to help student borrowers rehabilitate their student loans and build on the successes of the direct loan program. These responsibilities include effective management and oversight of federal student aid programs.

In my view, the U.S. Department of Education's move to 100 percent direct lending in 2010 continues to provide students with a streamlined loan origination system, a department with better oversight against waste, fraud and abuse, and taxpayers with a better deal.

One of the issues before this committee today concerns the Department of Education's transition to the Debt Management System II and the glitches that the Department of Education encountered with this system through the year 2012. I understand that between that period of 2012 to 2013 the Department of Education's inspector general issued a series of alert memos to the student aid office about the glitches in the system, and provided recommendations to address the issues.

To my knowledge, the FSA has taken these concerns very seriously and has corrected these weaknesses, including manually assisting borrowers in rehabilitating their student loans and clearing the backlog. By their fiscal year 2013 audit, FSA had resolved most of the areas noted by the I.G. Furthermore, the GAO report released today makes three recommendations to ensure that the department is tracking that rehabilitation of defaulted loans, properly noting risk associated with contractors, and improving the monitoring of contractor performance. I encourage the department to heed these suggestions and make necessary adjustments to improve the program.

Finally, I want to remind my colleagues on both sides of the aisle that not so long ago, under the prior administration, President Bush, this committee investigated and held oversight hearings that exposed and highlighted rampant conflicts of interest and unethical practices within the Federal Family Education Loan—better known as FFEL—program, especially lenders' use of bribes and kickbacks to curry favors with colleges. All that happened while I was here on this committee. As I recall, poor oversight of our federal student aid programs allowed inappropriate practices to go unchecked at the expense of student borrowers and their families.

It was disgraceful at that time when the department did little to nothing to stop student loan companies from offering university financial aid officers things such as gifts, trips and more to buy their way onto college campuses and increase their access to student borrowers. My message to you today is simple. The Direct Loan Program is here to stay because it is the best option for student borrowers and their families. We are not retreating to the Wild Wild West and the days when monitoring oversight and accountability of our federal student aid programs were neglected and ignored.

In terms of today's hearing, what is most important, it seems to me, is that the department has taken significant steps to fix these problems, and will continue to work effectively, manage and track the rehabilitation of those defaulted loans and federal student aid programs. I am looking forward to, and I am interested in exploring how the loan system can work even better for borrowers and taxpayers through upcoming contract negotiations between the department and its servicers and contractors.

And with that, Madam Chair, I yield back.

[The statement of Mr. Hinojosa follows:]

Thank you, Chairwoman Foxx.

Today's hearing will focus on student loan rehabilitation and the steps that the U.S. department of Education has taken to strengthen that process.

I want to thank our distinguished panel of witnesses for joining us this morning to provide some context for this discussion and to share their views on how the federal government can continue to best serve student borrowers.

Let me begin by saying that the U.S. Department of Education must do all that it can to help student borrowers rehabilitate their student loans and build on the successes of the Direct Loan Program. These responsibilities include effective management and oversight of federal student aid programs.

In my view, the U.S. Department of Education's move to 100% direct lending in 2010 continues to provide students with a streamlined loan origination system, the Department with better oversight against waste, fraud and abuse, and taxpayers with a better deal.

One of the issues before this committee today concerns the Department of Education's transition to the Debt Management Collection System 2 and the glitches that the department of Education encountered with this system through 2012.

I understand that between 2012 and 2013, the Department of Education's Inspector General (IG) issued a series of alert memos to the Federal Student Aid Office (FSA) about the glitches in the system and provided recommendations to address the issues.

To my knowledge, the FSA has taken these concerns seriously and has corrected these weaknesses, including manually assisting borrowers in rehabilitating their student loans and clearing the backlog. By their FY 2013 audit, FSA had resolved most of the areas noted by the IG.

Furthermore, the GAO report released today makes three recommendations to ensure that the department is tracking the rehabilitation of defaulted loans, properly noting risk associated with contractors, and improving the monitoring of contractor performance. I encourage the department to heed these suggestions and make the necessary adjustments to improve the program.

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As I recall, poor oversight of our federal student aid programs allowed inappropriate practices to go unchecked at the expense of student borrowers and their families.

It was disgraceful at that time—when the department did little to nothing to stop student loan companies from offering university financial aid officers gifts, trips, and more to "buy" their way onto college campuses and increase their access to student borrowers.

My message to you today is simple: the Direct loan program is here to stay because it is the best option for student borrowers. We are not retreating to the Wild Wild West and the days when monitoring, oversight and accountability of our federal student Aid programs were neglected and ignored.

In terms of today's hearing, what is most important to me is that the department has taken significant steps to fix these problems and will continue to work to effectively manage and track the rehabilitation of defaulted loans and federal student aid programs.

Looking forward, I am interested in exploring how the loan system can work even better for borrowers and taxpayers through upcoming contract negotiations between the Department and its servicers and contractors.

With that, I yield back.

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Chairwoman FOXX. Thank you, Mr. Hinojosa.

Pursuant to committee rule 7(c), all subcommittee members will be permitted to submit written statements to be included in the permanent hearing record. And without objection, the hearing record will remain open for 14 days to allow statements, questions for the record, and other extraneous material referenced during the hearing to be submitted in the official hearing record.

It is now my pleasure to introduce our distinguished panel of witnesses. Ms. Melissa Emrey-Arras serves as the director of education, workforce and income security issues, at the U.S. Government Accountability Office. The Honorable Kathleen Tighe serves as the inspector general of the U.S. Department of Education. Mr. James Runcie serves as chief operating officer of federal student aid at the U.S. Department of Education.

I now recognize Mr. Loebsack to introduce our final witness.

Mr. LOEBSACK. Thank you Chairwoman Foxx. I am pleased to introduce Peg Julius today, financial aid director at Kirkwood Community College. Kirkwood's main campus is located just outside my district in Cedar Rapids, although I did have Kirkwood in Cedar Rapids for 6 years prior to the last redistricting. But there is also a campus in Iowa City for Kirkwood Community College. You can correct me, Peg, but I think that the college enrolls around 16,000 or 17,000 students now. Is that correct, somewhere in that neighborhood?

Ms. JULIUS. I have got 23,000.

Mr. LOEBSACK. All right, I apologize. I have already offended one of our witnesses.

[Laughter.]

I should have known that. My staff person over here, Bonnie, is saying, "I told you so." But it serves a lot of the counties in my district, as well. Peg is also a member of the executive council of the National Direct Student Loan Coalition. I have worked with her on college affordability issues since I have been in Congress the last eight years but, of course, I have known Peg for much longer than that. And I know that she is an expert in her field and, beyond that, she is my constituent to boot. So I look forward to her testimony.

I look forward to all the testimony today, and I thank the chairwoman and I yield back. Thank you.

Chairwoman FOXX. Thank you, Mr. Loebsack.

Before I recognize you to provide your testimony, let me briefly explain our lighting system. You will have five minutes to present your testimony. When you begin, the light in front of you will turn green. When one minute is left, the light will turn yellow. When your time is expired, the light will turn red. At that point, I ask that you wrap up your remarks as best as you are able. After you have testified, members will each have five minutes to ask question of the panel.

I now recognize Ms. Melissa Emrey-Arras for five minutes.

**STATEMENT OF MS. MELISSA EMREY–ARRAS, DIRECTOR, EDUCATION, WORKFORCE AND INCOME SECURITY ISSUES, U.S. GOVERNMENT ACCOUNTABILITY OFFICE, BOSTON, MASSACHUSETTS**

Ms. EMREY-ARRAS. Chairwoman Foxx, Ranking Member Hinojosa, and members of the subcommittee, I am pleased to be here to discuss our work examining the Department of Education's efforts to rehabilitate defaulted federal student loans. As of September 2013, about 94 billion, over 11 percent of federal student loans in repayment, were in default.

Loan rehabilitation allows borrowers who make nine on-time payments in 10 months to have the default removed from their credit report. Education contracts with collection agencies to assist borrowers with this process.

Education recently upgraded its defaulted loan information system because the old system had become costly to maintain and had many manual workarounds. My remarks will address two areas from our report, which is being released today. One, how the upgrade of Education's defaulted loan information system affected loan rehabilitation, and two, how Education oversees its collection agencies in implementing loan rehabilitation. Our review found that Education was unable to provide most borrowers who completed loan rehabilitation with timely benefits for more than a year following the upgrade.

We found the delays largely due to gaps in Education's oversight of its system contractor. For example, despite known risks such as concerns about the contractor's unreliable performance on previous system development efforts, Education did not have plans for monitoring the upgrade. We also found the department's testing of the new system was insufficient to detect problems associated with loan rehabilitation. For example, the system did not recognize when borrowers had made nine on-time payments in 10 months because it was only tested for seven months.

As Education worked to correct problems with the system, it took some steps to hold the contractor accountable. Education also established procedures to help eligible borrowers by removing defaults from their credit reports. However, borrowers had to request the help, and Education estimated helping less than 10 percent of the estimated 80,000 borrowers who were affected when the system was shut down. Education officials have reported that they are still using workarounds to run the system, and a substantial amount of development work will need to be completed under a new contract that was recently awarded.

The system challenges the new contractor will be expected to resolve provide a compelling case for Education to strengthen its oversight. To address this issue, we recommended that Education take steps to ensure necessary oversight for the new system contract. We also found that Education lacks data and related performance measures to inform its management and oversight of loan rehabilitation.

Education does not have data to assess the number or extent of borrower delays or the extent to which borrowers who rehabilitate their loans stay out of default. To address these data issues, we recommended that Education develop an approach for tracking loan rehabilitation performance.

Our work also identified weaknesses in Education's oversight of its collection agencies. Although Education's monitoring procedures required quarterly reviews of collection agency phone calls with borrowers, we found that Education did not consistently complete these reviews. The call review reports we examined also documented a range of errors, including collection agencies providing borrowers with misleading information. For example, in one case a collection agency incorrectly told borrowers that a debit card was required to rehabilitate a loan.

While Education provides feedback on the results of its call reviews to each collection agency, it does not assure that collection agencies actually take corrective actions. To address these issues, we recommended that Education improve its call review process. In conclusion, our findings highlight serious weaknesses in Education's management of the loan rehabilitation process. While Education has agreed with our recommendations and taken steps in response, it will be important to track how Education builds upon these actions to ensure it is providing appropriate oversight.

Thank you. This concludes my statement.

[The statement of Ms. Emrey-Arras follows:]

United States Government Accountability Office

GAO

Testimony
Before the Subcommittee on Higher Education and Workforce Training, Committee on Education and the Workforce, House of Representatives

For Release on Delivery
Expected at 2:30 p.m. EDT
Wednesday, March 12, 2014

# FEDERAL STUDENT LOANS

## Oversight of Defaulted Loan Rehabilitation Needs Strengthening

Statement of Melissa Emrey-Arras, Director, Education, Workforce, and Income Security

Chairwoman Foxx, Ranking Member Hinojosa, and Members of the Subcommittee:

I am pleased to be here today to discuss our work examining the Department of Education's (Education) efforts to rehabilitate defaulted federal student loans. As of September 2013 about $94 billion—over 11 percent of federal student loan volume in repayment—was in default.[1] Loan rehabilitation allows borrowers who make nine on-time monthly payments within 10 months to have the default removed from their credit reports.[2] Education contracts with collection agencies to assist borrowers with rehabilitation and other options for repaying defaulted student loans. The federal government has an interest in ensuring that the loan rehabilitation process works well given the potential savings from returning defaulted loans to repayment. However, when Education upgraded its defaulted loan information system in October 2011, there were reports that some loans remained in default after borrowers had made enough payments to rehabilitate the loans, raising questions about Education's ability to manage the loan rehabilitation program.

You asked us to examine Education's rehabilitation of defaulted student loans. My remarks today will address the following two areas and is based on our report, which is being released at this hearing: (1) how the upgrade of Education's defaulted loan information system affected loan rehabilitation; and (2) how Education oversees collection agencies in implementing loan rehabilitation.[3]

In conducting this work, we focused our review on loans included in Education's defaulted loan information system.[4] We reviewed Education's policies, procedures, and guidance; contracts and monitoring records for Education's system contractor and 22 collection agencies; fiscal year 2011-2013 collections and rehabilitation data; and relevant federal laws and regulations. We interviewed officials from Education, its defaulted

[1]Default generally occurs when a borrower fails to make a payment for more than 270 days. 20 U.S.C. § 1085(l); 34 C.F.R. §§ 682.200(b) and 685.102(b).

[2]20 U.S.C. §1078-6(a)(1)(A); 34 C.F.R. §§ 682.405(a)(2) and 685.211(f)(1).

[3]GAO, *Federal Student Loans: Better Oversight Could Improve Defaulted Loan Rehabilitation,* GAO-14-256 (Washington, D.C.: Mar. 6, 2014).

[4]According to Education, this includes about $55 billion in Direct and Federal Family Education Loan program loans held by the department.

student loan system contractor, and borrower advocacy and consumer protection groups. We also conducted site visits to a nongeneralizable sample of 6 collection agencies, based on factors such as loan volume and geographic location. Our work was performed in accordance with generally accepted government auditing standards.

## Limited Planning and Oversight of Education's Defaulted Loan Information System Upgrade Adversely Affected Loan Rehabilitation

Because of limited planning and oversight, Education was unable to provide most borrowers who completed loan rehabilitation with timely benefits for more than a year following the October 2011 upgrade of its defaulted loan information system. As a result, borrowers who made a good faith effort to rehabilitate their loans experienced delays in having the defaults removed from their credit reports and reinstating their federal student aid eligibility.

Education reported that the original information system, which had been in place since 1989, had become costly to maintain and many manual workarounds had been developed over the years to address emerging requirements. Education officials said it was also necessary to upgrade the system to handle the increased loan volume that the department was responsible for servicing.[5] Education invited six firms, including the original system contractor to submit proposals for upgrading the system in 2009. The original contractor subsequently offered to upgrade the system at no additional cost to the government. In June 2010, Education canceled the request for proposals and modified the original contract to include the upgrade. The contract addresses the management of student loans, including loan servicing, which involves tracking loans and accepting payments from borrowers. The modification also guaranteed the contractor a minimum of 5 million non-defaulted borrowers to service through the end of the contract. Education officials said that their decision was based on the contractor's experience with the original system, its proposal to develop the upgrade in 6 months, the ease of upgrading

[5] Education expected increased loan volume following passage of the Ensuring Continued Access to Student Loans Act of 2008, which provided the department with the authority to purchase or enter into commitments to purchase Federal Family Education Loans (FFEL) from lenders and secondary markets to help ensure continued access to federally guaranteed student loans in the wake of the economic downturn. Pub. L. No. 110-227, § 7, 122 Stat. 740, 746. Further, Education anticipated an increase in the number of borrowers with Direct Loans, from about 7 million borrowers to about 13 million borrowers, due to the SAFRA Act, which terminated the authority to make or insure new FFEL loans after June 30, 2010. Pub. L. No. 111-152, § 2201, 124 Stat. 1029, 1074 (2010).

through an existing contract, and the contractor's willingness to perform the work at no additional cost to the government.

In moving forward with the upgrade, Education did not conduct appropriate levels of oversight to ensure successful completion of the work. Specifically, Education's own Departmental Directive: Contract Monitoring for Program Officials identifies several risk factors that indicate greater contract oversight may be needed, and we found three were applicable to the system upgrade as shown in table 1.

**Table 1: Risk Factors Associated with the Defaulted Student Loan System Upgrade**

| Risk factor | Explanation |
|---|---|
| Contractor with no performance history or an unreliable or unstable performance history or financial condition | The contractor had an unreliable performance history and in fiscal year 2005 Education issued a cure notice to address concerns about its performance on the original system contract[a]. In addition, the contractor was subsequently acquired by a company that had no performance history with the department. |
| Whether multiple subcontractors provided services to the contractor | Multiple subcontractors provided a range of services to the contractor during the upgrade. |
| Degree of interrelatedness with other contracts or projects | The system is set up to receive transfers of defaulted student loans from Education's loan servicers and provides reports that are used to calculate compensation for collection agencies. |

Source: GAO analysis of Education documentation.

Note: Education's directive identifies four additional potential risk factors that we determined did not apply to the system upgrade: (1) a variable-price contract (the contract was fixed-price, presenting less cost risk to the government); (2) newly-incorporated or emerging organizations; (3) a high dollar amount (the contractor agreed to upgrade the system at no-additional cost to the government as part of broader negotiations on this contract); and (4) a contract with poorly defined objectives, unclear acceptance criteria, or contract requirements that are constantly changing.

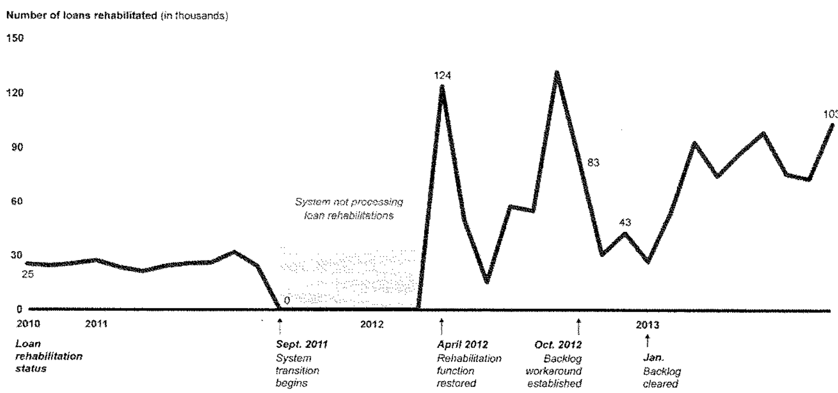
[a]A cure notice informs the contractor that the government considers the contractor's failure to make progress as endangering performance of the contract or the contractor has failed to perform contractual provisions other than delivery of supplies or performance of services. The cure notice specifies a period (typically 10 days) for the contractor to remedy the condition. If the condition is not corrected within this period, the cure notice states that the contractor may face termination of its contract for default. 48 C.F.R. § 49.402-3.

Despite these risks, Education did not have plans in place for monitoring the upgrade, and we found limited evidence of oversight conducted. Although Education officials acknowledged the monitoring plan for the original system contract was not relevant for overseeing the upgrade work, Education did not update it until 2011, about a year after the upgrade work began and performance problems, such as missed deadlines, had occurred. Education officials also acknowledged that they did not document many of their monitoring activities. In our review of contract files from May 2007 through December 2012, we found emails in which Education officials questioned the contractor's justifications for specific tasks in their proposals. However, we did not find required documentation of status reports, deliverables received, or plans for addressing upgrade-related problems.

Moreover, we found the department's testing of the new information system, which began in February 2011, was insufficient to detect problems associated with loan rehabilitation. For example, Education did not learn until shortly after the launch that the system did not recognize when borrowers had made nine on-time payments in 10 months because it did not test this function. Officials explained that testing in a 7-month time frame did not allow loan rehabilitation to be fully tested.

As a result of the system challenges, no loan rehabilitations were processed from September 2011 through March 2012, and Education officials said they needed until January 2013 to clear the resulting backlog (see fig. 1).

**Figure 1: Number of Loan Rehabilitations Processed, Fiscal Years 2011 through 2013**




Source: GAO summary of Education data.

Education worked with the contractor to identify and correct the problems and took some steps to hold the contractor accountable and assist borrowers.

- **Efforts to hold the contractor accountable.** While the system upgrade was completed at no additional cost to the government, the contractor also provided other services under the contract, such as loan servicing and providing Education with access to its data centers. In September 2011, Education began assessing the contractor financial penalties due to implementation delays. In February 2012, when the problems were still not resolved, Education notified the contractor via a cure notice that it could default on the contract unless adequate progress was made on the upgrade issues.[6] As of November 2013, Education reported withholding approximately $14 million from total payments to the contractor for other services rendered under the contract.[7]
- **Efforts to assist borrowers.** Education established procedures in November 2011 to assist eligible borrowers by removing defaults from their credit reports or reinstating their eligibility for student aid. However, borrowers had to contact the department or their collection agency to receive the assistance. Officials said they provided such benefits to about 7,600 borrowers—less than 10 percent—of the estimated 80,000 borrowers who were affected during the time the system was not processing rehabilitations.[8] Education officials said they did not systematically track when assistance was provided, and these rehabilitations were not processed through the system until April 2012 or later.

[6]A cure notice informs the contractor that the government considers the contractor's failure to make progress as endangering performance of the contract or the contractor has failed to perform contractual provisions other than delivery of supplies or performance of services. The cure notice specifies a period (typically 10 days) for the contractor to remedy the condition. If the condition is not corrected within this period, the cure notice states that the contractor may face termination of its contract for default. 48 C.F.R. § 49.402-3.

[7]Education documented the settlement agreement it reached for withholding payments from the contractor based on implementation delays in a December 2012 contract modification.

[8]Education processed about 20,000 to 30,000 loan rehabilitations a month in fiscal year 2011, prior to the upgrade. While Education was not able to track loan rehabilitations by borrower prior to the upgrade, officials said they have estimated that borrowers who use loan rehabilitation typically have two to three defaulted loans.

When Education's upgraded information system began processing loan rehabilitations in April 2012, the system still did not always recognize that eligible accounts had satisfied the requirements for loan rehabilitation. As a result, Education had to implement system workarounds and begin manually processing loan rehabilitations. While Education officials reported they stopped using manual processing in September 2013, they acknowledged that the system still requires workarounds and a substantial amount of development work will need to be completed to address remaining issues. Education expects the work to be completed under a new contract, which was awarded in September 2013. The system challenges the new contractor will be expected to resolve provide a compelling case for Education to strengthen its oversight. Without incorporating a risk-based approach to oversight into its planning for systems contracts and modifications, the department may continue to receive products and services that are delivered late and of unacceptable quality.

We also found that Education lacks data and related performance measures to inform its management and oversight of loan rehabilitation. According to The Office of Federal Student Aid's Fiscal Year 2011-2015 Strategic Plan, Education needs to be able to collect, analyze, and use customer data to achieve its goals of providing superior service and information to students and ensuring program integrity and safeguarding taxpayers' interests. Education reported rehabilitating about 600,000 loans for 200,000 borrowers from April 2012 to January 2013, as it worked to address the backlog of loan rehabilitations. However, Education has not developed performance data to assess the number or extent of individual borrower delays, or the extent to which borrowers who rehabilitate their loans stay out of default. Without such data and related performance measures, Education cannot assess its performance in serving borrowers or how effective rehabilitation is in minimizing the risk of defaulted loans to the federal government.

To address these issues, we recommended that Education strengthen its oversight by:

- developing an approach for tracking loan rehabilitation performance; and
- taking steps to ensure that the final monitoring plan for the new defaulted loan information system contract identifies risks and the oversight activities planned to address them.

Education concurred with the recommendations and highlighted actions it is taking in response to them. For example, Education stated that it has begun developing additional metrics for overseeing loan rehabilitation performance, and that it has established a monitoring plan for the new system contract that tracks key risk areas and identifies risk mitigation strategies.

## Oversight Weaknesses Reduce Education's Ability to Effectively Monitor Collection Agency Performance

We also found that key weaknesses reduce Education's ability to effectively monitor collection agency performance and ensure borrowers receive accurate information about loan rehabilitation. While Education's monitoring procedures call for quarterly reviews of each collection agency's phone conversations with borrowers, we found Education had not consistently completed such call reviews. For example, we examined call review reports issued between September 2011 and March 2013 for the six collection agencies we visited; however, Education was unable to provide documentation for 11 of the 42 call reviews that should have been performed. Education officials said the reviews may not have been completed due to competing priorities, such as needing to reassign staff to manually process loan rehabilitations following the system upgrade.

The call review reports we examined documented a range of errors for each of the six collection agencies we visited, including providing borrowers with inaccurate or misleading information about rehabilitation program requirements and options. Among other things, Education documented instances where collection agency representative(s):

- did not explain rehabilitation provisions such as the one-time opportunity to rehabilitate a loan, that payments must be made within 20 days of the due date to be considered on time, or options for obtaining a reasonable and affordable payment;
- continued to push loan rehabilitation after the borrower said he was unemployed and was unable to make payments; and
- provided false or misleading information, such as incorrectly telling borrowers that a down payment or debit card was required to rehabilitate a loan.

While Education provides feedback on the results of its call reviews to each collection agency, it does not ensure that collection agencies take corrective actions and does not systematically analyze the results over time or across collection agencies to inform its oversight activities. Without a systematic approach to monitoring the results of call reviews, Education may be missing opportunities to target its oversight and improve program performance.

To address these issues we recommended that Education take steps to improve its collection agency call review process. Education concurred with the recommendation and stated that it is revising its procedures to improve documentation of corrective actions and developing a database to track collection agency errors and associated corrective actions.

In conclusion, the findings in our report highlight serious weaknesses in Education's management and oversight of the loan rehabilitation process. The substantial delays that many borrowers experienced getting their loans out of default are largely attributable to Education not providing oversight appropriate to the risks associated with the system upgrade. While Education took steps to process the backlog of loans eligible for rehabilitation, it does not have performance data to provide assurance that borrowers are no longer experiencing delays. In addition, Education's oversight of collection agencies provides little assurance that borrowers are provided accurate information about loan rehabilitation. Education has taken some steps to strengthen its oversight in response to our recommendations. However, given the preliminary nature of these efforts, it will be important to track how Education builds upon and sustains these actions over time to ensure it is providing appropriate levels of oversight.

Chairwoman Foxx, Ranking Member Hinojosa, and Members of the Subcommittee this concludes my statement. I would be pleased to respond to any questions that you or other Members of the Subcommittee may have.

## GAO Contact and Staff Acknowledgments

For questions about this statement, please contact Melissa Emrey-Arras at (617) 788-0534 or emreyarrasm@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this statement. Individuals making key contributions to this statement include Debra Prescott, Assistant Director; Kurt Burgeson, Maria Gaona, Amy Moran Lowe, and Jason Palmer.

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*FEDERAL STUDENT LOANS: OVERSIGHT OF DEFAULTED LOAN REHABILITATION NEEDS STRENGTHENING*

Statement of Melissa Emrey-Arras, Director

Education, Workforce and Income Security Issues, GAO

Chairwoman Foxx, Ranking Member Hinojosa, and Members of the Subcommittee:

I am pleased to be here to discuss our work examining the Department of Education's efforts to rehabilitate defaulted federal student loans. As of September 2013 about 94 billion dollars—over 11 percent of federal student loans in repayment—were in default. Loan rehabilitation allows borrowers who make nine on-time payments in 10 months to have the default removed from their credit reports. Education contracts with collection agencies to assist borrowers with this process. Education recently upgraded its defaulted loan information system because the old system had become costly to maintain and had many manual workarounds.

My remarks will address two areas from our report, which is being released today: (1) how the upgrade of Education's defaulted loan information system affected loan rehabilitation; and (2) how Education oversees its collection agencies in implementing loan rehabilitation.[1]

Our review found that Education was unable to provide most borrowers who completed loan rehabilitation with timely benefits for more than a year following the upgrade.

We found the delays largely due to gaps in Education's oversight of its system contractor. For example, despite known risks, such as concerns about the contractor's unreliable performance on previous system development efforts, Education did not have plans for monitoring the upgrade.

We also found the department's testing of the new information system was insufficient to detect problems associated with loan rehabilitation. For example, the system did not recognize when borrowers had made nine on-time payments in 10 months because it was only tested for 7 months.

As Education worked to correct problems with the system, it took some steps to hold the contractor accountable. Education also established procedures to help eligible borrowers by removing defaults from their credit reports. However, borrowers had to request the help, and

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[1]GAO, *Federal Student Loans: Better Oversight Could Improve Defaulted Loan Rehabilitation,* GAO-14-256 (Washington, D.C.: Mar. 6, 2014).

Education estimated helping less than 10 percent of the estimated 80,000 borrowers who were affected when the system was down.

Education officials have reported they are still using workarounds to run the system and a substantial amount of development work will need to be completed under a new contract that was recently awarded. The system challenges the new contractor will be expected to resolve provide a compelling case for Education to strengthen its oversight.

- To address this issue, we recommended Education take steps to ensure necessary oversight for the new system contract.

We also found that Education lacks data and related performance measures to inform its management and oversight of loan rehabilitation. Education does not have data to assess the number or extent of borrower delays, or the extent to which borrowers who rehabilitate their loans stay out of default.

- To address these data issues, we recommended Education develop an approach for tracking loan rehabilitation performance.

Our work also identified weaknesses in Education's oversight of its collection agencies. Although Education's monitoring procedures required quarterly reviews of collection agency phone calls with borrowers, we found that Education did not consistently complete these reviews.

The call review reports we examined also documented a range of errors including collection agencies providing borrowers with misleading information. For example, in one case, a collection agency incorrectly told borrowers that a debit card was required to rehabilitate a loan.

While Education provides feedback on the results of its call reviews to each collection agency, it does not ensure that collection agencies take corrective actions.

- To address these issues we recommended Education improve its call review process.

In conclusion, our findings highlight serious weaknesses in Education's management of the loan rehabilitation process. While Education has agreed with our recommendations and taken steps in response, it will be important to track how Education builds upon these actions to ensure it is providing appropriate oversight.

Thank you, this concludes my statement.

Chairwoman FOXX. Thank you very much.

I now recognize the Honorable Kathleen Tighe for five minutes.

**STATEMENT OF HON. KATHLEEN TIGHE, INSPECTOR GENERAL, U.S. DEPARTMENT OF EDUCATION, WASHINGTON, D.C.**

Ms. TIGHE. Thank you very much. As members of this subcommittee know, the federal student assistance programs have long been a major focus of our audit and investigative work. Because of its significant student loan portfolio, FSA is, in fact, one of the largest financial institutions in the country. And, as such, effective oversight and monitoring of its programs and operations are critical. As I will discuss today, the Office of Inspector General has identified significant issues with FSA's debt management collection system.

When loans being serviced by FSA's loan servicers reach 360 days of nonpayment, they are transferred to FSA's debt management collection system, at which time FSA notifies the borrower that the loan is in default and asks the borrower to make repayment arrangements. If there is no response from the borrower, or if the borrower refuses to pay, FSA then assigns the loan to a collection agency. Since 2003, FSA has contracted with ACS Education Solutions to manage its debt management system. ACS was later purchased by Xerox, and in 2010 that company agreed to update the system.

The updated system is known as the Debt Management Collection System II. That system went live in October 2011. In 2012, we notified FSA that we had identified more than 190,000 defaulted loans in certain categories totaling more than $1.1 billion that could not be transferred from the FSA loan servicers to DMCS II. As a result, FSA was unable to undertake collection activities and eligible borrowers were unable to take steps to remove their loans from default status through loan rehabilitation. We also identified problems with transferring loans back from DMCS II to the FSA loan servicers.

We made a number of recommendations to FSA to address the issues with DMCS II. FSA stated it was committed to resolving the problems, but has yet to provide us with an acceptable corrective action plan to address our recommendation on how it will ensure that it has a fully operational debt management system. The inability of DMCS II to process certain types of transactions and other system problems contributed to a material weakness in internal control over financial reporting in the fiscal year 2012 FSA financial statement audit. As reported in the fiscal year 2013 FSA financial statement audit, a full year after we had first identified problems with DMCS II, issues still remained with the transfer of some defaulted loans in the system, as well as other issues.

Although the issue was designated now as a significant deficiency rather than a material weakness, the financial statement audit noted that as of September 30, 2013, although some functionality had been restored, 1.1 billion of defaulted loans still had not been transferred to DMCS II. In addition, action on four of the five recommendations made in the previous year's report were still in process and not yet completed. The problems with DMCS II, however, went beyond accounting for defaulted loans. In

May 2013, we reported that DMCS II could not provide the information necessary for FSA to calculate actual commissions and bonuses for private collection agencies.

As a result, in fiscal year 2012, FSA paid 448 million in commissions and 8.3 million in bonuses to private collection agencies based on estimates. My office is very concerned with the problems posed by DMCS II and FSA's inadequate oversight in monitoring of this system. As a result, we initiated additional work involving DMCS II and planned to take a broader look at FSA's oversight management and monitoring of its data systems overall. We also highlighted the problems with DMCS II in our most recent management challenges report and added a new management challenge related to the department's IT system, development and implementation. We will continue to closely monitor FSA's action to improve DMCS II.

This concludes my statement. I am happy to answer any questions.

[The statement of Ms. Tighe follows:]

**Testimony of Kathleen S. Tighe, Inspector General**
**U.S. Department of Education**
**Before the**
**Education and the Workforce Committee**
**Subcommittee on Higher Education and Workforce Training**
**U.S. House of Representatives**
**March 12, 2014**

Chairwoman Foxx, Ranking Member Hinojosa, and members of the Subcommittee, thank you for inviting me here today to discuss the U.S. Department of Education (Department) Office of Inspector General's (OIG) work involving the Department's Debt Management Collection System 2 (DMCS2). I appreciate the opportunity to share with you information on this issue and our efforts to ensure integrity and efficiency in the Federal student aid programs and operations.

As members of this Subcommittee know, the Federal student aid programs have long been a major focus of our audit, inspection, and investigative work, as they have been considered highly susceptible to fraud and abuse. The programs are large, complex, and inherently risky due to their reliance on numerous entities, the nature of the student population, and the amount of funding involved. Through its Federal Student Aid office (FSA), the Department disburses approximately $140 billion in student aid annually and manages an outstanding loan portfolio of $1 trillion. This makes it one of the largest financial institutions in the country. As such, effective oversight and monitoring of its operations are critical. As I will discuss today, OIG has identified issues relating to the lack of effective oversight and monitoring of FSA's student loan debt management system and the impact that has had on its operations.

**Background on the Debt Management Collection System 2**

FSA utilizes a debt management collection system to manage defaulted student loans. The system facilitates the storage, retrieval, and editing of debtor information and uses the information to help collect defaulted loans. When loans being serviced by FSA's loan servicers reach 360 days of non-payment, they are transferred to FSA's debt management collection system. Once a loan is in the debt management collection system, FSA notifies the borrower that the loan is in default and asks the borrower to make repayment arrangements. If there is no response from the borrower or if the borrower refuses to pay, FSA then assigns the loan to one of a number of collection agencies. FSA's debt management collection system also supports its contracts with these collection agencies.

On November 20, 2003, FSA entered into a contract with ACS Education Solutions, LLC, a company later purchased by Xerox in 2010 (ACS/Xerox), to service direct loans. The contract also included a requirement that it operate FSA's debt management system (the original Debt Management Collection System, or DMCS). In June 2010, ACS/Xerox agreed to update DMCS to DMCS2 to include specific baseline functional system requirements, which were specified in a contract modification. FSA originally planned to implement DMCS2 in October 2010 and FSA documentation stated it would do so no later than January 1, 2011. That timeframe was significantly delayed. ACS/Xerox did not test the transfer of defaulted loans to DMCS2 until January 2011 and FSA did not ensure that ACS/Xerox tested DMCS2 through the full life cycle of a defaulted loan. In September 2011, FSA began migrating files to DMCS2, and in October 2011, which was 9 months to a year after the planned launch date, DMCS2 went live.

**OIG-Identified Concerns with DMCS2**

In June 2012, during an OIG audit of the Title IV Additional Servicers (TIVAS) contracts, we became aware of issues surrounding the inability of DMCS2 to accept transfer of certain defaulted student loans from the TIVAS. During our site visits at two of the four TIVAS, Great Lakes Educational Loan Services, Inc. (Great Lakes) and Nelnet Servicing (Nelnet), we learned that some defaulted loans transferred to DMCS2 were rejected. FSA officials confirmed that this problem was also occurring with loans serviced by the other two TIVAS, the Pennsylvania Higher Education Assistance Agency and SLM Corporation, and by ACS/Xerox. The defaulted loans being rejected included redefaulted loans and loans held by borrowers with more than one defaulted loan.

If a defaulted loan cannot be transferred from a TIVAS to DMCS2 through no fault of the TIVAS, FSA pays the TIVAS $0.50 per borrower per month for continued servicing. However, the TIVAS are limited in their ability to actively service defaulted loans. Although the TIVAS can accept payments on defaulted loans, they cannot perform collection activities or advise borrowers on ways to remove their loans from default status. After a loan is transferred to DMCS2, FSA or an entity acting on its behalf (such as a collection agency) may pursue collection of the loan through a number of activities. For example, FSA can request offset or withholding of a borrower's Federal income tax refund and garnish the borrower's wages. If a loan is not transferred to DMCS2, FSA cannot undertake collection activities. The inability to transfer defaulted loans to DMCS2 also affects those borrowers who are eligible for loan rehabilitation, as they are unable to take steps to remove their loans from default, which GAO discusses in depth in its report.

In addition to problems with transfers to DMCS2, we also identified problems with transferring loans from DMCS2 to the TIVAS. If a borrower rehabilitated a loan residing on DMCS2, the system could not transfer the loan to a TIVAS to resume normal repayment servicing. As a result, the student could not be removed from default status. FSA officials acknowledged that there were loans affected by this problem. Great Lakes officials identified a related problem that DMCS2 did not always permit a TIVAS to recall a loan transferred to DMCS2 if the TIVAS subsequently received documentation proving that the loan was not in default, such as when a borrower is deceased or received a loan deferment. These borrowers may have been adversely affected by collection activities, such as income tax withholding and administrative wage garnishment, because their loans were transferred to DMCS2 and could not be recalled.

Due to the seriousness of the issues with DMCS2, we issued an alert memorandum in December 2012 that highlighted the concerns mentioned above, noting that more than 190,390 loans totaling more than $1.1 billion had been impacted. These concerns were further detailed in the fiscal year (FY) 2012 FSA financial statement audit (performed by an independent public accountant under OIG oversight), which noted that FSA had experienced significant difficulties with DMCS2 since it went live in October 2011. These included the inability of the system to process certain types of transactions, the untimely preparation of certain reconciliations, untimely reporting of interest accrual calculations, untimely reporting of transactions from DMCS2 to the Department's financial management system, and ineffective information technology controls and oversight of FSA's contractor responsible for DMCS2. These issues contributed to a material weakness in internal control over financial reporting of Federal student aid data that was reported in FSA's FY 2012 financial statement audit.

The problems with the DMCS2, however, went beyond accounting for the defaulted loans. In May 2013, we issued an alert memorandum that highlighted yet another concern that arose from problems with DMCS2. During the course of an OIG audit examining FSA's handling of borrower complaints against private collection agencies (PCAs), we learned that DMCS2 could not provide the information necessary for FSA to calculate actual commissions and bonuses for PCAs. As a result, FSA paid $448 million in commissions and $8.3 million in bonuses to PCAs in FY 2012 based on estimates. In FY 2012, FSA had individual contracts with 23 PCAs to perform collection services on defaulted student loans. PCAs are paid commissions based on successfully collecting on defaulted loans, and a PCA qualifies for bonuses based on its performance relative to other PCAs. Before it transitioned to DMCS2 in September 2011, FSA used its previous system to calculate PCA commissions and bonuses based on actual collections data contained in the system. However, because DMCS2 has been unable to produce the data necessary to calculate commissions and bonuses, FSA allowed PCAs to submit invoices, without supporting documentation, to calculate and pay estimated commissions and paid estimated bonuses based on bonus payments made in previous years.

Further, more than a year after we first identified problems with DMCS2, issues still remained, as indicated in the FY 2013 FSA financial statement audit. Although no longer considered a material weakness, the independent public accountant performing the financial statement audit still designated it as a "significant deficiency" needing immediate attention and improvement.

The report noted ongoing problems with the transfer of some defaulted loans to DMCS2, untimely recording of the default loan transfer transactions to the general ledger, errors affecting the interest rate and calculation of interest on defaulted loans, errors and delays in recording cash receipts during the year resulting in differences with U.S. Treasury reporting, and errors and delays during the year that resulted in aged balances of unapplied loan payments.

**OIG Recommendations and FSA Response**

Our December 2012 alert memorandum on DMCS2 made five recommendations to FSA, including (1) that FSA identify each problem related to the DMCS2 loan transfers, the source of each problem and the entire population of loans adversely affected, and (2) that FSA determine whether DMCS2 can become a fully operational system that will meet all of the baseline functional system requirements, and if it will not, that FSA develop a plan to address the deficiencies or determine whether to obtain a replacement debt management system. In addition, the FY 2012 FSA financial statement audit report made five recommendations, including that FSA ensure that the DMCS2 contractor resolves and completes the remaining system requirements in order to bring the system into a fully operational status. Both reports recommended that FSA establish temporary work-around solutions for all identified DMCS2 problems until permanent solutions were implemented.

In response to our December 2012 alert memorandum, FSA stated that it was committed to resolving outstanding problems with DMCS2 as quickly as possible; however, it has yet to provide us with an acceptable corrective action plan on our recommendation to address how it will ensure that it has a fully operational debt management system. With regard to the recommendations made in the FY 2012 FSA financial statement audit, FSA originally stated that all corrective actions related to DMCS2 were complete. However, the FY 2013 FSA financial statement audit, issued in December 2013, noted that action on four of the recommendations made in the previous year's report were still in process and not yet completed. It also made six additional recommendations for needed improvements to the system. FSA has submitted a corrective action plan for these six recommendations, although no actions have been completed at this point.

Further, in our May 2013 alert memorandum regarding the commissions and bonuses paid to PCAs, we recommended that FSA calculate any overpayments or underpayments of PCA commissions and bonuses based on actual data, require PCAs to return any overpayments to the Department, address any underpayments, and require PCAs to submit supporting documentation for all commissions invoiced since October 2011. FSA stated that it has developed a workaround for calculating bonuses and correcting overpayments and underpayments and that its corrective action for calculating commissions and reconciling the commissions would be completed in April 2014.

**Current and Planned OIG Work**

My office is very concerned with the problems posed by DMCS2 and FSA's apparent lack of oversight and monitoring of this system. As a result, we initiated an evaluation of DMCS2's functionality to determine whether FSA accurately assessed the operating status of the DMCS2 functions that it indicated to be fully or partially functioning, including workaround procedures. We look to complete this audit in the coming months and will share our findings with you once final. Also, due to the issues we identified with DMCS2, we determined that it was necessary to take a broader look at FSA's oversight, management, and monitoring of its data systems. Our FY 2014 Annual Plan, which presents the work we intend to conduct throughout the year, includes two audits specific to this issue: an audit of FSA's oversight of the development and enhancement of its information technology products and systems, and an audit of FSA policies and procedures for oversight and monitoring of its contracting process. We expect to begin these audits in the coming months. We also highlighted the problems with DMCS2 in our FY 2014 Management Challenges Report and added a new management challenge related to the Department's information technology system development and implementation.

My office has also been taking a closer look at FSA's oversight of PCAs. In May 2013, we issued an alert memorandum to FSA's Chief Operating Officer that FSA was not enforcing a contract requirement that PCAs report verbal complaints from borrowers. We became aware of the issue during our audit of the handling of borrower complaints against PCAs. The contracts between PCAs and FSA provide that each PCA will adhere to FSA complaint procedures. Those procedures mandate specific actions a PCA must take when it receives a complaint from a borrower, including verbal complaints, such as suspending collection activity on the account. During our site visits at three PCAs—Pioneer Credit Recovery, Performant Financial Corporation, and NCO Financial Systems, Inc.—we learned that none considered verbal complaints to be actual complaints because they believed that they had been able to appease the borrower and defuse the complaint. In addition, we found that no PCAs tracked or reported verbal complaints. As a result, FSA was unaware of the number or severity of verbal complaints filed by borrowers against PCAs and how those complaints were resolved. We expect to issue our final report on the handling of borrower complaints in the coming months.

**Closing**

In closing, I would like to thank the Subcommittee again for inviting me to participate in this hearing today, and I look forward to working with all of you to help ensure that the Federal student aid programs meet the needs of America's students and families. This concludes my written statement. I am happy to answer any of your questions.

Chairwoman FOXX. Thank you both very much. You come in under time.

Mr. Runcie, you have a challenge. I now recognize you for five minutes.

[Laughter.]

**STATEMENT OF MR. JAMES RUNCIE, CHIEF OPERATING OFFICER, FEDERAL STUDENT AID, U.S. DEPARTMENT OF EDUCATION, WASHINGTON, D.C.**

Mr. RUNCIE. Well, thank you, Chairman Kline, Chairwoman Foxx, Ranking Member Hinojosa, and members of the subcommittee for inviting me to testify today. My name is James Runcie, and I am the chief operating officer of the Department of Education's Federal Student Aid office. Our organization is responsible for administering the federal student aid programs that annually enable millions of students to pursue higher education.

While managing defaulted loans is a significant, important part of our work at FSA, it is only one part of a successful public-private partnership encompassing over 1,300 government employees and more than 10,000 employees of private contractors. Together, we administer the federal student aid programs. We do this by, among other things, processing more than 20 million financial aid applications each year, dispersing $138 billion in grants and loans, providing management and oversight of a loan portfolio of more than 1 trillion—representing 40 million borrowers—and collecting on defaulted student loans, the topic of this hearing.

We have worked closely with the GAO and the department's I.G. over the last several years. We appreciate their insights and concur with the three recommendations presented by GAO in its most recent report. We acknowledge that there were major challenges, and I hold myself accountable for these issues. Today, the major challenges presented by the new DMCS system have been addressed. Collections on defaulted loans are at record levels, and have grown from $3.4 billion in 2011 to $8.5 billion in 2013.

However, to provide a broader context for this hearing, I would like to review with the committee how we got to where we are today. Since 1994, there have been two primary federal student loan programs, the FFEL program and the Direct Loan Program. In 2007, the DL Program's share of the annual 64 billion in federal student loan disbursements was approximately 20 percent. Around that time, the decline in the financial markets began to directly affect student lending by severely restricting the availability of private capital. Many schools began moving from the FFEL to the DL program. As the number of schools moving to the DL program increased, we took steps to insure FSA had sufficient capacity.

Beginning in 2008, we increased our loan origination capacity to ensure that it could handle the projected volumes. We also augmented our servicing capacity with the awarding of loan servicing contracts to four private sector companies. In addition, we began the process of upgrading an antiquated 30-year-old default management system called DMCS. In 2010, we successfully implemented the transition to full, direct lending. And last year, FSA disbursed approximately $100 billion in direct loans to over 10 million students and parent borrowers. This is an increase of almost 700 percent in just five years.

In order to successfully manage this exponential growth, we successfully upgraded legacy systems and processes and developed many new ones. Some examples include the implementation of the TIVAS not-for-profit servicers, IRS automated data retrieval, and new total and permanent disability system. We successfully oversee dozens of major systems and process tens of millions of transactions, leveraging our employees and numerous private contractors. Having said that, FSA's transition to a new DMCS system faced difficulties, particularly during its initial months of operations.

Our management team immediately took steps to assess the problem and to restore key functions. Our efforts prioritized restoring borrower services, such as loan rehabilitation and refund processing, and minimizing disruptions to the collection activities. As a result of these efforts, the system is working today and we are processing a greater number of rehabilitations than any time in our history. We have also instituted regulatory, contractual, and process improvements since 2012 that make loan rehabilitation easier for borrowers.

The new debt management system has replaced a system that was 30 years old, technologically and functionally limited, and subject to a number of security issues and audit findings. The new system was designed to be more secure, more robust, and less costly. We also levied appropriate and necessary sanctions against a contractor for poor performance. These actions included the issuance of a cure notice and the imposition of significant financial penalties. Late last year, we moved into the final phase of ending our relationship with the original contractor and awarded a new contract for DMCS.

The new system's loan rehabilitation functions were restored in April of 2012, and the backlog of borrowers whose loan rehabilitation was delayed was resolved by January 2013. Over 525,000 borrowers have rehabilitated defaulted loans, with a value of more than $9 billion since functionality was restored. As a result of these efforts, we are processing record numbers of collections in all categories. Defaulted borrowers have better service and more options than at any time in the history of our programs. We have learned from the system transition, and are incorporating lessons into the management improvements across the organization.

I want to thank the committee for providing me the opportunity to discuss this very important issue, and look forward to answering any questions that you may have this afternoon.

[The statement of Mr. Runcie follows:]

**Testimony of**
**James W. Runcie**
**Chief Operating Officer**
**Federal Student Aid**
**U.S. Department of Education**

Before the Subcommittee on Higher Education and Workforce Training,
House Education and the Workforce Committee

Hearing on
"Examining the Mismanagement of the Student Loan Rehabilitation Process"

March 12, 2014

Thank you Madam Chairwoman, Ranking Member Hinojosa and Members of the Subcommittee for inviting me to testify before the Subcommittee as you examine the rehabilitation of defaulted student loans.

My name is James Runcie and I am the Chief Operating Officer of the Department of Education's Federal Student Aid office. Our organization is responsible for administering the Federal student financial assistance programs that annually enable millions of students across this country to pursue higher education.

While managing loans in default and loan rehabilitation is a significant and important part of our work at Federal Student Aid, it is only one part of a successful public-private partnership encompassing over 1,300 government employees and more than 10,000 employees of private contractors. Together we administer the Federal student aid programs by, among other things, conducting outreach to high school students and to other college-bound students and their families, processing more than 20 million financial aid applications each year, determining student aid eligibility, disbursing billions of dollars in grants and loans, servicing the accounts of millions of student loan borrowers, performing oversight of program participants and, what we are here to discuss today, collecting on defaulted student loans.

<u>Background</u>

To place Federal Student Aid's responsibilities and current scope of operations in the proper context for this hearing, I would like to review with the Committee how we got to where we are today.

Since 1994, there were two primary Federal student loan programs in this country – the Federal Family Education Loan (FFEL) program, through which private lenders using private capital made federally guaranteed loans to students; and the Direct Loan program, through which the Department of Education made loans directly to students. Prior to the economic downturn beginning in 2007, the Direct Loan program's share of $64 billion Federal student loan annual disbursements was approximately 20 percent with FFEL program loans comprising the remaining 80 percent. At the time, Direct Loans accounted for approximately 21 percent of the $509 billion outstanding student loan portfolio.

Starting in 2007, the decline in the financial markets affected student lending by restricting the availability of capital for private lenders to make FFEL loans. Many schools, reacting to the economic and financial landscape, began moving from the FFEL program to the Direct Loan program. As the number of schools moving to the Direct Loan program increased, Federal Student Aid took steps to assume responsibility for additional Direct Loan volume.

Beginning in 2008, we increased our stand-by loan origination capacity to handle the projected volumes of new Direct Loans. We also augmented our Direct Loan servicing capacity with the awarding of loan servicing contracts to four contractors. Understanding that there would continue to be large increases in the number of borrowers, we also began updated the FSA default management system.

As you are aware, the Student Aid and Fiscal Responsibility Act (SAFRA), enacted in 2010, ended the origination of new loans in the FFEL program and thus made all new Federal student loans available only through the Direct Loan program beginning in July 2010. FSA successfully implemented the transition to full direct lending and in FY 2013 the Department disbursed approximately $100 billion dollars in Direct Loans to approximately 10.6 million student and parent borrowers. This is an increase of almost 700 percent in just five years.

Today, Federal Student Aid originates 100 percent of the over 100 billion dollars in new Federal student loans. Federal Student Aid manages a Federal student loan portfolio of FFEL and Direct Loans of approximately one trillion dollars for more than 40 million borrowers. We have successfully managed substantial growth in the Title IV Federal financial aid programs and continue to serve our customers—students and families—by providing information, tools and resources they need to pursue postsecondary education. In FY 2013, Federal Student Aid successfully delivered $138 billion in Federal grants, loans and work study aid to more than 14 million eligible students and their families.

Challenges Associated with Loan Rehabilitations and DMCS

Going from approximately 20 percent to 100 percent of the Federal student loan originations and the accompanying servicing and default management have not been without some challenges. Beginning in 2012, we started working with the Department's Inspector General (IG) to address these issues. These challenges are discussed in the General Accountability Office's (GAO) report, *Federal Student Loans: Better Oversight Could Improve Defaulted Loan Rehabilitation.* Addressing these challenges has been a major focus of Federal Student Aid management and we are proud of our success in overcoming the initial hurdles noted in the GAO report. We have also instituted significant regulatory, contractual, and process improvements since 2012 that make loan rehabilitation easier for borrowers and for collection agencies and loan servicers to implement. That said, we are aware of and concerned with the delays and disruptions to the loan rehabilitation process that occurred on in 2011 and 2012 and I take full responsibility. We have worked hard to ensure that this situation does not happen again. Accordingly, I share the concerns raised by GAO and appreciate its thoughtful suggestions.

This matter should not detract from the incredible accomplishments of the Federal Student Aid workforce who manage a $138 billion student aid program that serves more than 14 million students and families attending over 6,000 institutions of higher education.

In late 2011 FSA implemented the new Default Management and Collection System (DMCS). As with all transitions, we faced a number of challenges, particularly during its initial months of operation in late 2011 and early 2012. The new DMCS replaced a legacy system that was nearly 30 years old, technologically and functionally limited, and subject to a number of security issues and audit findings. This legacy system was operated under a larger contract that expires on June 30, 2014 and provides other services to Federal Student Aid.

Beginning in 2010, we began negotiations with the contractor to prepare for the wind-down and close-out of the contract. As part of those negotiations, the contractor agreed to develop, implement, and document a new debt management and collection system at no additional contract cost to the government. This allowed Federal Student Aid to cancel a planned Debt Recovery System development contract, thereby saving in excess of $10 million in budgeted development costs.

The new DMCS system was designed to be more secure, more robust, and less costly than the legacy system. A pilot version of the new system was launched for 5,000 newly defaulted borrowers in February 2011. Following testing and a pilot conversion in early September of more than 150,000 additional borrowers, all three million defaulted borrowers on the legacy system were transferred to the new DMCS beginning in September 2011; the new system went live in October of that same year.

As noted in GAO's report, we encountered a number of significant issues following the full implementation of the new system including many issues related to data integrity deficiencies of the 30-year old legacy system. As a result, certain key functionalities such as payment processing, correspondence production and account transfer capabilities either took much longer than expected or failed to work properly at the higher post-transfer volumes.

Federal Student Aid immediately took steps to assess the problems and to restore key functions. Our efforts prioritized restoring borrower services, such as loan rehabilitation and refund processing, and minimizing disruptions to collection activities. Wherever possible, we limited the impact on borrowers as we worked through the system issues. For example, during the period when loan rehabilitations were delayed, we established borrower relief initiatives through which we manually cleared credit histories and re-established Title IV student aid eligibility for over 8,000 borrowers who were eligible for loan rehabilitation.

We also levied appropriate and necessary contractual sanctions against the contractor for poor performance including the issuance of a cure notice and the imposition of significant financial penalties. After the system was developed, but while the contractor was unable to perform all of the required functions, Federal Student Aid withheld over $50 million in contract payments until the contractor could demonstrate adequate performance. As a result, Federal Student Aid did not ultimately pay approximately $11 million (of the $50 million) of contractor costs. Additional actions may occur in the broader negotiations at the contract's end, on June 30, 2014. Late last year, we ended our relationship with the original contractor and awarded a new contract for the management of DMCS.

Functionality Restored

The DMCS's loan rehabilitation functions were fully restored in April 2012 and the backlog of borrowers whose loan rehabilitation was delayed was resolved by January 2013. Over 525,000 borrowers have rehabilitated defaulted student loans with a value of more than $9 billion dollars since functionality was restored, including a record $5.6 billion in FY 2013.

The Department of Education has achieved record overall collection totals in both FY 2012 and FY 2013. Collections on defaulted loans have grown from approximately $3.4 billion in FY 2011 to $3.7 billion in FY 2012 to $8.5 billion in FY 2013. DMCS now has the capacity to support the Department's collection activities including providing an effective and efficient loan rehabilitation process. In addition, the new system is more secure, has fewer manual workarounds, and boasts many enhanced features such as web access for borrowers and weekly rather than monthly loan rehabilitation processing. Despite the system's initial issues, I believe that the new DMCS system represents an important upgrade in services to better support defaulted student loan borrowers and to protect the taxpayer investment in student loans.

Moving Forward

We have worked closely with GAO over the last two years. We appreciate its insights and concur with the report's three recommendations. In fact, we have already begun to address their suggestions:

- We are developing additional metrics for use in overseeing loan rehabilitations. We are working with both private collection agencies (PCAs) and our loan servicing contractors to develop statistics to identify and resolve process issues affecting loan rehabilitations quickly.

- We have established a contract monitoring plan for DMCS that tracks explicit deliverables related to key risk areas. In addition, the new DMCS contract requires that the vendor use Lifecycle Management Methodology (LMM) in managing any development activity. The LMM process includes the production and ongoing monitoring of detailed risk logs and mitigation strategies for all projects. Lastly, Federal Student Aid has procured an independent verification and validation (IV&V) service for DMCS to ensure that all appropriate processes and controls are in place. While these steps will significantly reduce any risks, we will continue to review our monitoring and oversight processes and plans to determine whether additional actions are needed.

- We have also strengthened our procedure for reviewing telephone calls by our collection agencies, giving particular and regular attention to loan rehabilitation calls. We have revised the monitoring procedures to improve the documentation of corrective actions by pCAs). We have also developed a database to track errors discovered in PCA reviews and to identify those PCAs with a pattern of errors. The database will also document PCA corrective actions.

- We are considering improvements such as more extensive trending and data analysis to inform our oversight of collection agency activities. The corrective actions tracked in the new database will also contain each error identified in each review, allowing Federal Student Aid staff to analyze PCA performance to identify and address problem areas and poor performers. While these steps will significantly improve the call review process, we will assess their impact to determine whether additional actions are needed.

The Department has also revised its guidance on how Direct Loan debt collectors calculate the "reasonable and affordable" payment in the loan rehabilitation process. Borrowers are required to make nine "reasonable and affordable" payments before their loans can be rehabilitated and their credit histories cleared. We directed the Direct Loan collection agencies to calculate those payments as no more than 15 percent of their discretionary income. The Department extended this directive to FFEL debt collection agencies in regulations (effective July 1, 2014).

In an effort to be completely transparent with taxpayers, we self-reported a material weakness associated with the DMCS system conversion in the Department's FY 2012 Annual Financial Report and FSA's FY 2012 Annual Report. This material weakness was an aggregation of the control deficiencies, some relating to the rehabilitation process. The Department's IG agreed with our self-assessment and reported a material weakness in its audit of the Department's and FSA's FY 2012 financial statements. During FY 2013, FSA aggressively addressed these control deficiencies and made significant progress in fixing them. As a result, the Department eliminated that material weakness in FY 2013, and the Department and Federal Student Aid once again have no material weaknesses on their financial statement audits.

The new DMCS has now been operating for two years. We are processing record numbers of collections in all categories and defaulted borrowers have better service and more options than at any time in the history of our programs. We have learned from these system transition problems and are incorporating those lessons into management improvements across the organization.

At an organizational level, our priority remains service to our customers through the effective and efficient delivery of Federal financial aid, prudent management of our outstanding loan portfolio, and proper oversight of our programs. This will further our students' educational pursuits, safeguard taxpayer dollars, and ensure the viability of these programs.

I want to thank the Subcommittee for providing me the opportunity to discuss this very important issue and I look forward to answering any questions you may have this afternoon.

Chairwoman FOXX. Thank you, Mr. Runcie.
I now recognize Ms. Peg Julius for five minutes.

**STATEMENT OF MS. PEG JULIUS, EXECUTIVE DIRECTOR OF ENROLLMENT MANAGEMENT, KIRKWOOD COMMUNITY COLLEGE, CEDAR RAPIDS, IOWA**

Ms. JULIUS. Chairwoman Foxx and members of the subcommittee, thank you for the opportunity to speak to you today. My name is Peg Julius and I am a member of the executive council of the National Direct Student Loan Coalition, and executive director of enrollment management and financial aid at Kirkwood Community College in Cedar Rapids, Iowa.

We are a 2-year public institution, enrolling approximately 23,000 students annually. Fifty-one percent of them receive student financial aid, and 34 percent receive Pell grants. Kirkwood joined the direct lending program in the second year, 1995. I believed strongly then, and I continue to believe now, that direct lending is the best student loan option for our students. It is understandable for students and their families, it is simple, and it works. When borrower benefits were being used to entice schools away from direct lending in the late 1990s, my administration moved out of direct lending and back to the Federal Family Educational Loan Program.

After 3 years of participation in FFEL and many concerns about the level of service that was provided to our student borrowers, the opportunity presented itself for us to move back to direct lending and my staff and I happily made that change. The direct loan program continues to be the best student loan option. The switch to 100 percent direct lending in 2010 was an enormous undertaking by the Department of Education. As with any change of this magnitude, fine tuning continues to happen. The coalition believes that servicing of loans could be improved with the following changes.

Borrowers need a single point of contact for all their loan repayment activities. The new option for students to choose their servicer during consolidation provides opportunities for abuse and fraud in the industry, and should be eliminated. Service levels, loan terms and borrower benefits must be equal and uniform. Performance measures should be relevant and uniformly applied to all servicers. We encourage the department to take advantage of the opportunity by the renewal of servicing and collection contracts to move that system to the best practices of the industry as a whole.

The department has worked hard and accomplished much, correcting the issues with private collection agencies and the loan rehabilitation process. Despite the simplicity of the direct loan program, there are still challenges for students making repayments. And when students don't pay their loans, the resulting default is concerning both for them and for the taxpayers of this nation. We suggest that all correspondence from servicers use the identification of the Federal Direct Stafford Loan Program as the primary identifier. Students need to understand that this is a federal loan provided by Congress, and not a loan from a servicer.

We believe that these changes will make the current model for direct lending and servicing even better than it is today. We are encouraged by improvements made in the consolidation process for students on studentloans.gov. Real-time information about all the loans that a student has and an easy process for pulling IRS information for income-based repayment options will no doubt reduce defaults. Yet still, students find themselves with defaulted loans for a variety of reasons. The need for the rehabilitation of these loans is not uncommon.

While the process is not quick, it is also not daunting. Most can navigate the process on their own. When students ask for our help, it is a fairly easy handoff from the repayment counseling that we provide to the processes required by the department to put the loan in a rehabilitated status. There were serious reporting problems for rehabilitated loans when the change in debt collection servicing occurred. The systems are operating properly now, and those problems have been resolved.

I want to thank you, Madam Chairman, for the opportunity to speak with you today. I am honored to give you some perspective on this very important issue from the student borrower and school viewpoint. And I am happy to answer any questions.

[The statement of Ms. Julius follows:]

**Statement**

**Of**

**Peg Julius**

**On behalf of the National Direct Student Loan Coalition (NDSLC)**

**Before the**

**House Subcommittee on Higher Education and Workforce Training**

**Hearing on**

**"Examining the Mismanagement of the Student Loan Rehabilitation Process"**

**March 12, 2014**

**2175 Rayburn H.O.B**

**Washington DC**

Chairwoman Foxx, Senior Democratic Member Hinojosa, and members of the subcommittee, thank you for the opportunity to speak to you today.

My name is Peg Julius, a member of the Executive Council of the National Direct Student Loan Coalition and Executive Director of Enrollment Management, and Financial Aid Director at Kirkwood Community College in Cedar Rapids, Iowa. We are a public 2-year institution enrolling approximately 23,000 students annually, 51% receive student financial aid, and 34% receive Pell Grants. Kirkwood joined Direct Lending in the second year of the program, 1995. I believed strongly then, and continue to believe now, that Direct Lending is the best student loan option for our students. It is understandable for students and their families, it is simple, and it works. When borrower benefits were being used to entice schools away from Direct Lending in the late 90's, my administration moved out of Direct Lending and back to Federal Family Education Loan Program (FFELP). Even at that time, I felt so strongly that Direct Lending was the best option that I made that change with much apprehension for my students and the service we would be able to provide for them. After three years of participation in the FFELP program, and many concerns about the level of service provided to our student borrowers, the opportunity presented itself to initiate a move back to Direct Lending. My staff and I happily made that change. The Direct Lending Program continues to be the best student loan option.

The switch to 100% Direct Lending in 2010 was an enormous undertaking by the Department of Education, and the National Direct Student Loan Coalition worked closely with them to ensure that the new schools joining the program would have the support they needed to make a successful transition. The Common Origination and Disbursement System works very well for schools, and was a great improvement on the procedure used to originate FFELP loans, which were processed with little standardization and common practices. The Direct Loan Coalition assisted hundreds of schools through our mentoring program, and the transition to 100% Direct Loans was smooth and uneventful. Students all got the money they needed to pay their bills, and schools were able to draw down funds without issue. As with any change of this magnitude, fine tuning continues to happen on the back end, particularly the servicing aspect. The Coalition has worked with Federal Student Aid to make suggestions on changes we believe would improve the student experience, and have included those in our suggestions for Re-authorization. We believe that the servicing of loans could be improved with the following changes:

- Borrowers need a single point of contact for all their loan repayment activities; we suggest that studentloans.gov is where they should go.

- This can be accomplished by having a single portal for all students that once entered can take them directly to their servicer.
- The new option for students to choose their servicer during the consolidation process provides potential for fraud and abuse in the industry and should be eliminated.
- Service levels, loan terms and borrower benefits must be equal and uniform.
- Performance measures should be relevant and uniformly applied to all servicers.

Competition among a limited number of servicers is healthy, too many servicers increase complexity and taxpayer cost. Complexity itself can increase defaults due to borrower confusion.

We encourage the Department to take advantage of the opportunity presented by the renewal of servicing and collection contracts to move that system to the best practices of the industry as a whole. We understand new approaches exist. Prior experience with student loans and use of old methods is not necessary to provide the most cost effective and best service to borrowers. It should be made clear to proposers that anyone in the industry is encouraged to compete. The department has worked hard and accomplished much, correcting the issues with the private collection agencies, and the loan rehabilitation process. This is not a Direct Lending issue, per se, but a Servicing issue, with communication between lenders, guarantees agencies, and the Department. Best practices in communication, for instance, allow for a consistency in servicing which is a key component to borrowers successfully repaying student loans.

Despite the simplicity of the program, there are still challenges for students when making repayments. Because the servicers are currently allowed to co-brand all mailings (either paper or e-mail) with their company name, students may not open the correspondence and thus, miss important information about their grace period and the repayment start date. This was not an issue when there was a single federal loan servicer and all correspondence was identified simply as "Federal Direct Student Loans". And when students don't pay their loans, the resulting default is concerning both for them and for the taxpayers of this nation. We suggest that correspondence from all servicers use the identification of the federal Direct Stafford Loan program as the primary identifier. The name of the servicer should be a secondary or nonexistent identifier to assure students understand the importance of the communication. Students need to understand this is a federal loan provided by Congress, not a loan from a servicer.

We believe these changes will make the current model for Direct Lending and servicing even better than it currently is.

We are encouraged by improvements made in the consolidation process for students on studentloans.gov. Real-time information about all the loans a student has, and an easy process for pulling in IRS information for income based repayment options will no doubt reduce defaults. The Direct Loan Coalition would suggest that all borrowers be placed into Pay As You Earn (PAYE) repayment option by default, unless the student opts out. There should be clear information about the possibility that the student might be paying more interest over time, and that there is always the option to send extra with each payment. We see an opportunity for modifying the income based repayment options into a single option, easier to understand, and allowing students to opt out easily as they are able to pay more on their student loans, thus saving on the total interest that they pay.

Students find themselves with defaulted student loans for a variety of reasons. The need for rehabilitation of those loans is not uncommon. We find that students come to us for two main reasons, because they need to return to school, and want to reinstate their eligibility for financial aid, or because they are in a situation where their credit history affects them. We have found that while the process is not quick, it's also not daunting. Most can navigate the process on their own, but when students ask for our help, it's a fairly smooth hand off, from the repayment counseling we provide, and the processes required by the Department to put the loan in a rehabilitated status. There were serious reporting problems for rehabilitated loans when the change in debt collection servicing occurred. The systems are operating properly now and those problems have been resolved.

I want to thank you, Madam Chairman, for the opportunity to speak with you today. I am honored to be able to give you some perspective on this very important issue from the student borrower and school viewpoint. I'm happy to answer any questions.

Chairwoman FOXX. Thank you very much.

I am now going to recognize members for questions, and I would like to recognize the chairman of the committee, Congressman Kline.

Mr. KLINE. Thank you, Madam Chair. Thank the witnesses for being here. A question I just want to get really clear for the record here. Ms. Emrey-Arras, you touched on it in your testimony, but I want to get from you and Inspector General Tighe a straight yes or no answer here. I will start with you—we always start with the GAO. And thank you for your work, by the way. I know that this committee and others, we just lay a lot of work on the GAO, and we appreciate the high quality of the work.

So can you say, with certainty, that the department's default management system is fully functioning without any workarounds, and that all loan rehabilitations are now being properly processed within the appropriate time frames?

Ms. EMREY-ARRAS. No. Education continues to rely on system workarounds. In addition, Education has put together a long list of functional deficiencies with the system that will need to be addressed by the new contractor. And, in addition, Education lacks data to know for sure that there are no longer delays in the process.

Mr. KLINE. Thank you.

Inspector General Tighe, same question?

Ms. TIGHE. No.

Mr. KLINE. Exactly. Okay, thank you for that. And now again to the Inspector General. I have a nifty package put together here for us. I have got a couple of these alert memoranda dated May 8 and May 15 from your office to FSA. And in these, you point out significant oversight lapses by the department, which you have touched on. In both instances, the department's response indicated they agreed with your concerns and listed action items they would undertake to address the concerns in your memoranda. In your follow up, has the department demonstrated it has met the stated corrective actions?

Ms. TIGHE. Thank you. Regarding the alert memo on DMCS II, we had a number of recommendations. The department has submitted a corrective action plan on all but one, but has not completed action. On the most significant recommendation we made, which is the recommendation that basically they need to do a plan to demonstrate that they have a fully functional debt management collection system, we do not have a corrective action plan on that yet.

Mr. KLINE. So, work to be done.

Ms. TIGHE. Work yet to be done, yes.

Mr. KLINE. Well, again, I want to thank you for your work, for your testimony. And that is what we are getting at here. We understand that there are people of good will here trying to get things done. But the point of the matter is, the fact of the matter is, we still got big problems. And so I appreciate all of you being here today and your testimony.

And with that, Madam Chair, I will yield back.

Chairwoman FOXX. My goodness, this chairman is setting a great example also.

Mr. Bishop, I now recognize you for five minutes.

Mr. BISHOP. Thank you very much, Madam Chair. And thank you very much for holding this hearing. This is a very important area, and I thank you for shedding light on it. And thank you to the panel.

My first question is, it is my belief that this is a systems problem correction as opposed to there being something inherent in direct lending that contributed to this problem. Is it exclusively a systems problem?

Ms. TIGHE. Based on our work, it is a systems problem.

Mr. BISHOP. Okay. Mr. Runcie, you would concur with that?

Mr. RUNCIE. Yes, this is a systems issue that we have taken great effort to address. And we believe we have addressed it. But it is not a direct lending policy issue.

Mr. BISHOP. Chairman Kline just asked if there were problems that remain. Ms. Emrey-Arras, you said yes. Ms. Tighe, you said yes. Mr. Runcie, you said in your testimony that, quote— "functionality has been restored," close quote. And I know that is a different matter than whether problems remain. Can you tell us how your department is addressing the problems that continue to exist, that have been highlighted by the Inspector General and by GAO?

Mr. RUNCIE. Yes. First of all, the rehab issue. We put a fix in April of 2012. And then we cleaned out the backlog by the end of the year. So that issue is addressed. And so on a go-forward basis, you know, that functionality has been restored. In terms of the issue about workarounds, they're supporting processes—we have always had supporting processes. In the old system we had many workarounds, or supporting processes, to address issues that couldn't be handled directly by the system.

We have less workarounds now than we did before we had the system. In our definition of a supporting process, a workaround that works is one that addresses the issue on a timely basis. So therefore, our workarounds are not creating any backlogs. So if there is a workaround process, there are no backlogs, so the borrower is not experiencing a detrimental situation.

So this issue of fully-functioning or functioning system I think it can also be evidenced by the fact that we have increased the amount of collections, rehabs and collections in total, to a level of almost $9 billion since we put in that functionality. So from an operational definition of success, we would point to that as empirical evidence.

Mr. BISHOP. Okay. Let me ask this question, and I would ask this of the GAO and the Inspector General. Are you confident that the department has put in place the appropriate remedial action and the appropriate oversight steps to see to it that if Madam Chair were to bring us all back together 6 months from now or 9 months from now we would be viewing a different landscape than we are viewing right now?

Ms. TIGHE. From us, I am not confident. We actually have ongoing work right now on DMCS II. One of those is to basically, you know, look over FSA's shoulder and look at what they have set as functional and not functional. That work is still ongoing and will not be out for a little while, but we are checking on their claims of functionality. We also had started a job that we put aside because there was a big protest related to the follow on contract that is at issue here, that we would have looked at FSA's plans to sort of deal with all these issues. We haven't yet decided what to do with that job.

Mr. BISHOP. So your monitoring is ongoing.

How about the GAO?

Ms. EMREY-ARRAS. We are also monitoring. While Education has agreed with our recommendations, we need to monitor them to see that those steps that they have promised are taken and that they fulfill the requirements of the recommendations.

Mr. BISHOP. Okay. Thank you all very much.

Chairwoman FOXX. Thank you very much, Mr. Bishop.

Mr. Walberg, you are recognized for five minutes.

Mr. WALBERG. Thank you, and thanks to the panel for being here.

Ms. Emrey-Arras, let me ask you first if you could, in more detail, describe the department's lack of oversight in its system—over its system contractor? And more specifically, what did you find when you looked through the department's contract files?

Ms. EMREY-ARRAS. Thank you for that important question. We found that Education did not create a monitoring plan for the upgrade prior to the beginning of the work on the system, and only became involved after the contractor began missing deadlines, and created a monitoring plan about a year after everything got going.

Mr. WALBERG. Is that normal for—

Ms. EMREY-ARRAS. That should not be normal. Actually, the department has guidance for contracting, and it recommends that people look to what risks are involved. And if a contractor has past performance problems, there should be more monitoring in place to mitigate those risks. And this contractor had those past performance problems, and oversight was not put in place up front when it needed to be to appropriately monitor the contractor.

In terms of looking at the files, we did not find that monitoring documentation that the department requires of its employees in terms of status reports, other documents to show that they were really monitoring the contractor.

Mr. WALBERG. Interesting. Seems common sense was missing there, to a point. But who am I to know about that?

Ms. Tighe, in your opinion, should the issues highlighted in your May 2013 alert memorandum have been spotted by the department if they had proper oversight and monitoring practices in place?

Ms. TIGHE. Yes, I do believe those issues should have been spotted. I think the principal problem, other than the underlying problem regarding the loans that would not transfer that we observed, was the failure to do proper testing of the system before it went live. That is a problem we recognize was also a problem recognized by the financial statement auditor in 2013. That is, the fact that they only tested certain functions and didn't test all the way through the process of a loan and through rehabilitation, I think, created problems. I think if those things had been done we wouldn't have the problems we have today.

Mr. WALBERG. How much of your office's time has been spent in dealing with this issue of this contract?

Ms. TIGHE. Well, we have had two alert memos and we have ongoing work. We have spent just under a million dollars on staff time, on travel, and on related overhead for this work.

Mr. WALBERG. Well, that is certainly part of your responsibility. But if it doesn't have to be done. Are there any other audits that have been delayed because of this work?

Ms. TIGHE. Well, we prioritize our work according to the issues that we think are important. And this, when it burbled up, clearly became a top issue for us. So we did put some things aside and decided to give priority to this.

Mr. WALBERG. Okay.

Mr. Runcie, contracting for services, as you would readily admit, is an important obligation, especially when it obligates millions of dollars of taxpayers' funds. Why did the department award a contract for these important services to an entity that had demonstrated failures of its own in the past?

Mr. RUNCIE. Okay. Well, we did not award a contract. There was an existing contract that we modified. So we did not award a contract, so there wasn't a process. We ended up awarding a contract this past year. So it was considered almost more of an upgrade.

Mr. WALBERG. But the contract was continued. It wasn't, as you say, the word wasn't "awarded."

Mr. RUNCIE. There was an existing contract that was modified to provide for an upgrade of the system that was already there.

Mr. WALBERG. With known problems from the contractor.

Mr. RUNCIE. Well—

Mr. WALBERG. Was it modification meant to take of those known problems and to address those?

Mr. RUNCIE. Well, the issue about its past performance had to do with systems integration work, not with the debt management collection system. There was some systems integration work involving four disparate systems that was a part of a contract, or an obligation. And that is what was not addressed. The actual operations and maintenance in delivery cycles around DMCS was not the issue that resulted in the past performance.

Mr. WALBERG. As I understand it, 80,000 borrowers were impacted by this failure. Could you quantify what that means to each of those individuals, and even to the economy?

Mr. RUNCIE. The 80,000 borrowers that were not able to get loan rehab, by definition they were rehabilitated. But the clearing of their credit and the eligibility for Title IV funds was not an automatic process. The borrower relief process that was—

Mr. WALBERG. What does that mean?

Mr. RUNCIE. It means that we put in place a borrower relief process. So they would contact us and we would contact the credit agencies to clear their credit, or if they needed a letter or any clearance for Title IV eligibility, we would provide that. And we provided that to about 8,000 people who called us.

Mr. WALBERG. I see my time has expired, Madam Chair.

Chairwoman FOXX. Thank you, Mr. Walberg.

Ms. Bonamici, you are recognized for five minutes.

Ms. BONAMICI. Thank you very much, Madam Chairwoman. Thank you for holding this hearing, which provides an opportunity for us to highlight the important work that is being done to make sure that Americans who have defaulted on their student loans aren't victimized and are given a reasonable chance to return to good standing. And I appreciate the work that has been done so far. It looks like there is still some work to do.

I wanted to make sure, Ms. Honorable Tighe, you set out the procedure here: 360 days of nonpayment, and then it goes to the FSA debt management. And then if there is no response, or a refusal to pay, then it goes to a collection agency. Is that all correct?

Ms. TIGHE. Yes, that is correct.

Ms. BONAMICI. And can I ask you, Ms. Tighe or Mr. Runcie, how is the collection agency chosen? How do you decide which collection agencies to use?

Ms. TIGHE. I would defer to Mr. Runcie.

Ms. BONAMICI. Mr. Runcie, how do you make that determination?

Mr. RUNCIE. There is an allocation process, I believe, based on performance. I don't have the details on that, but that is what I believe.

Ms. BONAMICI. And do you look at their record of whether they have been sued under the Fair Debt Collection Practices Act, for example?

Mr. RUNCIE. Yes. As a part of the oversight process, we review them for compliance under the terms of the contract, any other issues that might impact their ability to collect on behalf of the Department of Education.

Ms. BONAMICI. So Ms. Emrey-Arras, you said in your report that there was an effort to assist borrowers. You said that there were procedures in November 2011 to assist eligible borrowers by removing defaults from the credit reports or reinstating their eligibility. However, borrowers had to contact the department or their collection agency to receive the assistance. So then it said that less than 10 percent were actually affected. So can you talk about whether there was follow up? You or Mr. Runcie or Ms. Tighe, was there follow up with these borrowers to make sure that they got the assistance they needed to reinstate their eligibility?

Mr. RUNCIE. All of the backlog was cleared. So the remaining—you know, if you subtracted the 8,000 from the 82,000—say, 72,000 were cleared out of backlog. So if they were eligible for being rehabilitated and getting their credit cleared, or the default cleared, entitled for eligibility, they would have received that by now.

Ms. BONAMICI. Okay. So there has been, you know, plenty written about the practices of certain debt collection agencies. Mr. Runcie, does your organization comply with the Fair Debt Collection Practices Act?

Mr. RUNCIE. I assume so. I mean, all of our debt collectors have to comply with the Fair Debt Collection Act or they would not be—you know, that would be violation, I assume, of their contract terms.

Ms. BONAMICI. So since there has been the direct loan program, has there been an increase or decrease in borrowers' complaints?

Mr. RUNCIE. Based upon one metric, there was, at the time that we put the system in, complaints jumped from .07 to .08 of a percent. And subsequently, it has gone down to a lower level than it was prior to the actual installation of the system.

Ms. BONAMICI. So now it is a lower level?

Mr. RUNCIE. It is a lower number.

Ms. BONAMICI. And what does the FSA do to help borrowers avoid going to a collection agent, being referred a collection agency? Are there efforts to encourage them to negotiate early on? Are there steps taken to warn them that if you do not handle this or make arrangements it will go to a collection agency?

Mr. RUNCIE. Yes. Yes, there are a number of financial literacy activities and tools. There is also entrance and exit counseling, some in-school counseling. We also have contractual terms that motivate, you know, the servicers to provide a level of education and process that would help defer or avoid, you know, students going into default. In addition, when the loans are turned over to us there is a sort of a 60-day period where we will reach out before we actually even send it out to the collection agency.

So, you know, we can always do more, and we are constantly putting more in the way of financial literacy and outreach out there. But we do have a pretty rigorous approach to trying to help students avoid default.

Ms. BONAMICI. And you also talked about the regulatory change to help define what a reasonable and affordable payment is. And it is my understanding that becomes effective in July. Is that correct?

Mr. RUNCIE. Yes, of previous year. So it allows default. It makes it easier for defaulted borrowers to rehabilitate their loans. Because their payments, the nine payments that they would make over a 10-month process, is now based upon a percentage of their income. So there is a higher likelihood that they can pay those amounts, rehabilitate their loan, get title IV eligibility, and get the default off of their credit. So before, there was some judgment and there was some negotiation.

But you know, after that point we were able to put that in place. And so you will also notice that after that became the standard, there was an increase in the amount of rehab. So it is actually, it is working.

Ms. BONAMICI. Terrific. Thank you. My time has expired.

I yield back. Thank you, Madam Chairwoman.

Chairwoman FOXX. Thank you, Ms. Bonamici.

Mr. Tierney, you are recognized for five minutes.

Mr. TIERNEY. Thank you very much.

Mr. Runcie, I note that in Ms. Tighe's report she indicates that there is a continuing problem of the non-report from the private contracting agencies, non-reporting on verbal complaints. Where does that stand now?

Mr. RUNCIE. That has been addressed. I mean, there was—you know, the PCAs thought that if they handled the verbal complaint, if they handled the verbal complaint over the phone—someone had an issue and they handled it—they felt that they didn't have to report that. We have provided much clearer guidance in terms of what must be reported, and we have noticed that we are getting notifications, and logging, you know, verbal complaints. So that has been addressed.

Mr. TIERNEY. Well I tell you, it bothers me that it took a report to get it addressed. I mean, that is a large part—you know, we have got great protections in this bill to go after and chase people who are in default, many of them facing circumstances that just the vicissitudes of the life put them in there. And we are beating them up. We garnish their wages, we take their tax funds, we go after Social Security benefits. Pretty onerous stuff.

And then for us to have to have a report to find out that these private contracting agencies aren't even reporting verbal complaints doesn't seem justified to me. And I hope that you are doing a better job of oversight, and not waiting for some report to come down the pike. Because I tell you, you know, I am gonna ask you whether or not you think that some of these collection agencies are just being unfairly difficult on people that are trying to get back from default or avoid default on that, and whether or not they are just being too onerous in the way they do it. What is your thought on that?

Mr. RUNCIE. Well, what we are looking at right now is, it was something that was noted in the report, the level monitoring of the PCAs. So we have increased the level of monitoring. Before, we were monitoring—we are supposed to monitor, you know, once a quarter. And based upon some of the workloads and some of the issues and resource contentions, we weren't consistent in doing that. We have now increased to four times a quarter, where we would listen in on calls and we would provide a higher level of oversight to make sure that borrowers aren't being harmed.

Mr. TIERNEY. Understand, I hear horror stories—you know, my constituents calling me—that would stand your hair on end about the way they are being treated by folks like that who end up putting them in a worse situation than they would otherwise be if somebody gave them the right attention and helped them out from the very beginning. We just can't have that on that basis. I will tell you what. I want your opinion of the Educational Credit Management Corporation and the way they go after people who may have had a health issue, or a loss of job and a health issue, trying to seek bankruptcy through the one small window that allows for any bankruptcy filing at all.

And the reports of the courts having to tell this agency that they are just being abusive and that they are stepping outside the bounds. What are you doing about that?

Mr. RUNCIE. Well, we use them for—I think that had to do with the guarantee agency side of their business and not the direct loan side of the business. Because our litigation goes through the Department of Justice, so that wouldn't have been an issue that we would have oversight on.

Mr. TIERNEY. So you don't deal with that at all?

Mr. RUNCIE. Not those issues related to the guarantee agency.

Mr. TIERNEY. All right. Because that should be troubling for all of us on that basis. What is your thought about, you know, letting some people have relief of these enormous loans, and they have had a problem for one reason or another with the system or with the PCAs overstepping their bounds or whatever? What can we do for those folks to get them back on track that doesn't leave them in the situation being 55 years old, having 98,000 worth of debt, and never be able to get out of this thing?

Mr. RUNCIE. Yes. I mean, I think there are some things that have been done in terms of, you know, income-driven repayment, you know. And then, you know, they have certain entitlements. But, I mean, I think some of those things are less operational and may be more policy. But there certainly are, you know, borrowers who have, you know, issues making the payments.

Mr. TIERNEY. Ms. Tighe, do you have any ideas of how you might help the department, you know, monitor this thing in a better way that gives people a fairer disposition of their situations?

Ms. TIGHE. The alert report you noted dealing with verbal complaints that we brought forward is actually done while we were out doing—we noticed that problem when we were out doing field work for an audit we have ongoing right now on borrower complaints against PCAs. So we should have a report out on that. I don't know the timetable, but perhaps sometime over the summer.

Mr. TIERNEY. Well, that will be helpful and I appreciate that. Thank you.

I will yield back.

Chairwoman FOXX. Thank you, Mr. Tierney.

I now recognize myself for five minutes. I wait until the end because I have to be here. Other folks can leave if they need to. I wanted to ask Ms. Emrey-Arras a question. You talked about—and I read your report really, very carefully—you talked about the need—and Ms. Tighe, you may want to respond to this also, of how the department sets up its data collection process. The inadequacy of the setting up the data collection process to begin with. And I know people have said over the years that things are close enough for government work.

But is there any way that the department can be alerted in advance of how to do the appropriate—set up the appropriate evaluation to begin with? We know that is the real key to getting the kind of information that you need. And we are dealing with people who aren't necessarily experts in this area. So does GAO have a mechanism for helping the department set these programs up in advance so that we are not retrospectively asking why aren't we collecting this information?

Ms. EMREY-ARRAS. That is a good question. The department actually has good guidance to help people identify when there may be risks involved and when more oversight is needed. So Education's own guidance suggests certain factors that would necessitate more attention being paid. Those include if a contractor has an unreliable performance history, if there are multiple subcontractors involved, and the degree to which the project is interrelated with other contracts or projects.

So I think looking at that departmental directive can help Education staff realize when a contract may be more risky, and be more attuned to putting monitoring steps in place early on.

Chairwoman FOXX. All right. And follow up just a little bit about that. Without putting words in Mr. Runcie's mouth, there was something said earlier about the fact that the department didn't award more contracts to the contractor that was not doing its work properly. But they did benefit by being allowed to stay on, as I recall from reading the report. So they did get a benefit by being allowed to do the additional work. Is that correct?

Ms. EMREY-ARRAS. That is correct. Although the contract modification was technically no cost, there was also an arrangement made where the system contractor was guaranteed $5 million in non-defaulted loans to service.

Chairwoman FOXX. Thank you.

Ms. Tighe, would you like to respond to those questions?

Ms. TIGHE. Well, I would agree with everything GAO said. And note that, you know, we have had concerns. Rather than sort of hit these contracts and these systems in onesies and twosies, you know, we really need to step back and look at where FSA is in terms of looking at these whole processes. Which is why we put these two jobs on our audit plan for this year. It is, let's look at, overall, at how their IT systems develop. DMCS II doesn't seem like a good example of how a system should be developed.

And I think that to the extent, as an example of how other systems may be handled now or in the future, it would be nice to come up with recommendations to FSA on how to do that better. Similar on its contracting processes, we have certainly gone in over the years and looked at onesies and twosies on contracts. We really want to look at the process more from a wider standpoint and make recommendations for improvement.

Chairwoman FOXX. Thank you.

Mr. Runcie, I appreciate the statements of commitment that you have made about wanting to do this work right and to make sure that the taxpayer is getting its appropriate payback on what is done in the department. And I appreciated also very much Mr. Bishop's comments. Can you tell us when there will be a plan that would be able to be evaluated to correct the problems that have been talked about here today?

Mr. RUNCIE. Yes. Well, we submitted a plan recently, and my understanding it is under review by the inspector general, the most recent plan. And I think, you know, that review might be tied to the other audit that is going on. But that notwithstanding, you know, we have put a plan in place that has resulted, I think, in some of the performance that we have talked about in terms of debt collections and clearing the rehab.

In addition, we have taken to heart what the I.G. and the GAO has said about making sure that we have a level of oversight on contracts going forward. So the new debt management collection system that we awarded does have independent verification, a validation vendor that is going to checkpoint all the milestones and go through the process to make sure that there is a level of quality assurance that is going on as the project is being developed. In addition to that, we are running it through our life cycle management methodology, which is a very rigorous process where we have risk logs and we track and we have remediation.

And so we have incorporated some of the lessons that we have learned as well as the guidance from the I.G. and GAO to make sure that as we move forward we can mitigate the risk and perform at the highest level possible.

Chairwoman FOXX. Thank you very much. Okay.

Well, I want, on behalf of all of the members of the subcommittee, to thank our witnesses for being here today. I think we have had a good hearing. Again, when Mr. Bishop left, he thanked me again for having the hearing. And I believe you all have helped us understand these issues a little bit better. I particularly appreciate, again, the report from the GAO. I appreciate what the I.G. is doing. Mr. Runcie, I appreciate your commitment to making things better here in terms of the service that we give to the students.

I also am very grateful for the comments that Mr. Hinojosa made in his opening remarks that he pointed out that we have a need for oversight. And we agree with him on our side of the aisle that we need this oversight no matter which administration is in place. It is our job as members of Congress to see that hardworking taxpayer money is being spent appropriately, and that the people that we are servicing through the Department of Education are treated appropriately.

I believe that this program is going to stay in place. And my major concern is that we not mistreat any students in any way or any people who are former students who had loans who want to get them rehabilitated. Our responsibility is just to make sure that they are treated appropriately.

Unfortunately, when you do this in the government there aren't usually very many incentives for getting the job done right and getting it done in a timely fashion. I wish we had a better way to do that than we have now.

But I will accept your commitment, Mr. Runcie, that the department wants to do these things right and will set in place a plan to make sure that everyone who is affected, has been affected, and will be affected in the future, will be treated appropriately.

There being no further business, the subcommittee stands adjourned. And thank you, again.

[Additional Submissions by Julius follow:]

NDSLC

National Direct Student Loan Coalition

Reauthorization of the Higher Education Act

Proposals for Legislative Change

September, 2013

**Reauthorization of the Higher Education Act**

**Proposals for Legislative Change**

## Executive Summary

Members of the National Direct Student Loan Coalition work to educate legislators and the public about issues related to student aid and student loan policy and to support all students who must borrow to achieve higher education goals. We serve as the voice of financial aid administrators in student loan policy and operational discussions while advocating state-of-the-art practices at the Department of Education.

It is in that context that we offer the following proposals for consideration during the reauthorization of the Higher Education Act. We appreciate the opportunity to provide input for this process and would welcome an opportunity to discuss our proposals with you.

The following provides a brief description of the issue and recommendations. A more thorough discussion of these recommendations is available on our website at www.directstudentloancoalition.org

**Simplify the Federally Held Loan Servicing Environment** by mandating contractor anonymity and limiting the number of contractors to five or fewer.

- Require that federal contractors who service loans act as invisible agents of the federal government with identical processes and policies
- Borrowers must have a single point of contact for all loan repayment activities with one web portal and one phone number for account access which utilizes available technology to route the borrower to the contractor
- Transfer of loans can be confusing, requiring the borrower to reinitiate automatic payments and on line access and contributes to delinquency
- Prohibit contractor "branding" and other marketing of the contractor's products to the borrower
- Service levels, loan terms and borrower benefits must be equal across contractors
- A limited number of contractors provides for healthy competition; too many contractors increase complexity and administrative cost

**Establish StudentLoans.gov as the Single Portal for All Borrower Transactions**

- Focusing borrower activity to a single site improves the simplicity and transparency of the federal loan process for the borrower
- Borrower information or inquiries initiated through this single portal can be transferred or assigned to the appropriate loan servicer and the transfer can remain invisible to the borrower

- A single portal eliminates the confusion that often occurs when loans are transferred between servicers since these transfers can remain invisible to the student
- This approach can reduce the cost of federal servicing since only one borrower 'front end' has to be created and maintained

**Establish a Single Income Driven Repayment Option** as the default repayment plan for all students.
- Monthly payments should not exceed 10% of the amount by which adjusted gross income exceeds 150% of the poverty level
- Interest should accrue but not be capitalized and should be capped at 50% of the original principle balance
- Utilize payroll deduction and IRS withholding processes to facilitate collection of monthly payments with annual reporting and reconciliation through the Department of Education
- Unpaid principle and interest should be forgiven after 20 years or 10 years for those engaged in public service positions
- The complexity of loan deferments and forbearance could be eliminated as could much of the current expense of federal loan servicers
- Borrowers could be given an option for accelerated payment through a 10 year standard repayment plan
- Cost savings could be used to provide programs that would incentivize current borrowers in the Direct and FFEL Programs to convert their debt to the new repayment option

**Loan Origination Fees Should be Eliminated** in the interest of transparency and simplification.
- With an interest rate structure that covers an appropriate portion of the cost of the program additional fees are not necessary
- Loan fees add to the complexity of the program

**Federal Student Loan Interest Rates** should flow in an equitable way to all borrowers and must promote access and completion. The following features would support these principles:
- The rate should be indexed to a Treasury Security
- The rate should include an amount which:
  - Covers an appropriate portion of the cost of the program
  - Allows for borrower subsidies
  - Reflects the difference in servicing cost for enrolled versus serviced borrowers
- The rate should be market driven and adjusted annually
- The rate should include built-in consumer protections in the form of interest rate caps that protect against excessive annual fluctuations and balance risk for the borrower and program cost

**Increase Undergraduate Loan Limits** to allow first year borrowers or students in a one year program to borrow up to $9,500; students beyond their first year should be allowed to borrow up to $12,500 and the cumulative limit should be raised to $47,000.
- Loan limits have not been raised since 2005
- Current limits are not adequate forcing many borrowers into more costly private loans
- Adequate annual and cumulative loan limits can encourage use of a single source for loans for education and enhance the potential for successful repayment
- Institutional flexibility to restrict annual or cumulative borrowing using professional judgment should be allowed to recognize desirable limits based on factors specific to an institution or individual borrower

**Allow Federal Loan Consolidation to All Borrowers at Least Once During Repayment**

- If other proposals to simplify loan repayment and interest rates are included in Reauthorization, loan consolidation would only be used by a portion of prior borrowers and would provide some equity to their situation
- Borrowers who obtained their loans during periods of high interest rates should not be forced to carry high interest rates for the life of the loan
- Offering a one-time option prevents continual reconsolidation as interest rates fluctuate
- To facilitate the consolidation process and support an informed decision, an electronic process utilizing borrower information in current federal systems should be mandated

**Eliminate the 150% of Program Length Limit on Eligibility for Subsidized Loans**

- Current satisfactory academic progress requirements and cumulative maximums limit a borrower's eligibility for loans
- Reduce complexities for borrowers by managing the cost of federal subsidies in the interest rate structure and within the established regulations that limit eligibility
- Limiting borrowing for retraining or career change does not support the need for a well-educated and nimble workforce

**Eliminate the Requirement that Loans for Students in the last term of their Undergraduate Career be Prorated**

- This requirement is contrary to the goal of college completion
- Reduces available resources for students at the end of their academic program
- Current annual and cumulative limits on federal borrowing make this requirement unnecessary

**Reduce the Need for Private Education Loans and Re-establish Bankruptcy Protections for Borrowers**

- Increase federal loan limits to provide one source for education loans
- Require school certification for all private loans to prevent over borrowing and provide opportunities for borrower education
- Reinstate bankruptcy protections for private education loan borrowers which will result in more judicious credit decisions by lenders

**Work within the Tax Code to Eliminate Loan Forgiveness as a Taxable Event**

- Change the statute to mirror the Perkins Program where loan forgiveness is not taxed
- Income based repayment programs which offer the possibility of loan forgiveness are typically beneficial to borrowers with low to moderate incomes and the 'forgiveness penalty' is an unreasonable cost for these borrowers
- Though we recognize that this is an issue for committees with jurisdiction over the tax code, there appears to be a common interest to be addressed by committees working on Reauthorization of the Higher Education as well

**Create One Federal Loan Program within Title IV of the Higher Education Act to Simplify the Process for Borrowers and Improve their Potential for Success**

- Reinvention of the Perkins Loan Program as part of the Unsubsidized Federal Direct Loan Program can bring simplicity to the federal loan programs while increasing available funding
- A simplified lending landscape lends itself to improved transparency for the borrower and provides an opportunity to implement innovations in the collection process using employer withholding
- A single federal loan program also creates an environment where borrower benefits and program costs can be more easily understood from a meaningful public policy view
- Incorporating concepts suggested here regarding borrower benefits, loan servicing and consumer protections would be important features of a single federal education loan program

## Expanded Discussion of Reauthorization Proposals

The proposals for consideration put forth by the National Direct Student Loan Coalition for consideration during the reauthorization of the Higher Education Act as presented in the Executive Summary are expanded on in the following pages.

**Simplify the Federally Held Loan Servicing Environment**

The current Direct Loan servicing environment is fraught with confusion, frustration and increasing default rates for student borrowers. There is an inherent flaw with the current multiple contractor environment—borrowers do not understand who holds their loan. Initially Direct Loan had one contractor, identified as the US Department of Education to borrowers. As of June 2013, there are 17 contractors servicing Direct Loans and marketing their companies to student borrowers. The number of contractors is set to double in the near future as more of the not-for-profit servicers become operational.

Contractors are inconsistent in their business processes and communication to borrowers. The multiple contractor system, in the growing numbers and present form, is costly to administer and inefficient. The two year national cohort default rate has increased in every year that we have had a multiple contractor environment. It's time to fix the multiple contractor system to simplify loan repayment for borrowers and reduce default rates.

Until another means of repaying student loans is available (such as IRS payroll deduction) the following changes are needed to restore clarity and simplification for students:

- Borrowers must have a single point of contact for all loan repayment activities
- Students should be given one web portal and phone number for loan servicing, with behind the scene technology routing the borrower to their contractor
- The identity of contractors should be invisible to the borrower
- The contractors should be mandated to use only the Department of Education's logo and name on any communication to the borrowers
- Contractor "branding" and other marketing of the contractor to the borrower should be prohibited
- Service levels, loan terms and borrower benefits must be equal and uniform
- Consistent processes and forms for common requests like deferment and forbearance should be the same for all contractors and available through electronic means
- Calculations of interest, fees, interest capitalization, and application of payments to principal and interest should all be standard and consistent among the contractors
- Performance measures should be relevant and uniformly applied to all contractors
- We support healthy competition among a limited number of contractors--too many contractors increase the complexity of the system and taxpayer cost

The Coalition also recommends that the mandatory participation of not-for-profit contractors previously approved by Congress should be eliminated. These mandated contractors do not provide value for borrowers, create confusion and require a taxpayer subsidy that is not efficient or justifiable.

**Establish StudentLoans.gov as the Single Portal for all Borrower Transactions**

Studentloans.gov is a portal for borrowers to complete many requirements of a Federal Direct Stafford or PLUS Loan including:

- Master Promissory Note
- Entrance Loan Counseling
- Exit Loan Counseling
- Financial Awareness Counseling Tool
- Loan Consolidation
- Income Based Repayment Application

Borrowers are familiar with this web site and recognize it as the portal for their federal loan activities. For continuity and simplicity this portal should be expanded to serve the borrower from application through repayment. Studentloans.gov should be enhanced to include a single portal to provide links for borrowers to:

- Review all loan history (NSLDS)
- Obtain forms necessary to complete deferments or forbearance
- Calculate repayment amounts for different repayment plans
- Contact their loan servicer
- Provide links to loan servicer systems that allow borrowers to access their account

When a student or parent borrower authenticates through studentloans.gov, this information should enable the borrower to access all their student loans.

**Establish a Single, Income-Driven Repayment Option**

The availability of multiple federal loan repayment options was intended to offer borrowers options to manage repayment of their federal student loans. Assumptions about the best repayment plan for students who failed to choose between existing options are less valid as average debt levels increase and employment opportunities decrease. We suggest a change in the paradigm: place all borrowers on an income driven repayment plan.

This proposed change will greatly streamline loan repayment, cutting costs to the government and reducing confusion for students. Defaults will be reduced and student borrowers will be treated consistently with borrower benefits for low income available to all who need this assistance. The proliferation of loan repayment options do not serve borrowers well, we need a simplified approach and suggest the following:

- All borrowers would be placed in one income based repayment plan; borrowers could be presented with the standard repayment amount needed to repay within 10 years, and can opt to pay this higher amount (or any other prepayment) at any time.
- Loan payments will be collected through payroll withholding to the IRS and passed through to the US Department of Education. Payment amounts will be reconciled annually with the US Department of Education issuing a bill to the borrower if not enough was collected based on annual income or if more collected than required, the borrower can opt for a refund or use the balance to reduce principal.
- Loan repayments are based on Adjusted Gross Income. No more than 10% of income above 150% of the poverty level based on family size will be assessed.
- Interest would not compound during repayment and would stop accruing once it equals 50% of the loan's balance at graduation.
- After 20 years of qualifying payments/months of economic hardship deferment, remaining loan balances would be forgiven. Those employed in full-time public service would qualify for loan forgiveness after 10 years.
- Loan deferments or forbearance for periods of unemployment or military service would be eliminated as repayment amounts would be calculated on the lower income of the borrower resulting in zero or low payment required.
- Loan repayment would begin 6 months after the student leaves school (or ceases to be enrolled at least half-time).
- If income is not verifiable through a tax document, then another means to assess payment will need to be developed.
- Current borrowers in the previous FFEL, IBR, ICR, standard, extended, graduated or other repayment plans would be given an incentive (reduction of interest rate of 1% or 2%) to convert to this loan repayment plan. This new IBR plan would be available to all borrowers, regardless of when they took out their existing Stafford loans.
- Because there is one loan repayment system, the need for the extended network of current servicers is eliminated. Competitive contracts for a small number and different types of contracts for the IRS and US Department of Education would need to be developed and issued.

**Loan Origination Fees Should Be Eliminated**

Loan fees add to the complexity of the federal loan program for borrowers and make the true cost of the loan less transparent. Borrowers understand that the interest paid on the loan is the cost of borrowing. Origination fees are similar to points charged for a mortgage—they are an added cost of borrowing but one that is obscure to the borrower and often misunderstood. A common misconception is that the school is keeping part of their loan.

If, as proposed in another section of this document, the federal interest rate structure is amended to be based on a treasury security with an index that balances the appropriate subsidies for the borrowers and cost to the taxpayer, additional fees would no longer be necessary.

Just as many other measures have been adopted to assist borrowers with understanding the terms and conditions of the loan, we urge elimination of the origination fee to simplify student loan pricing.

**Federal Student Loan Interest Rates**

Recent legislation that established the variable interest rates for federal student loans provided relief for borrowers and established a starting point for further improvements to the interest rate structure that could support program stability and borrower confidence. Given concerns about future rates under this legislation we expect that the discussion about federal student loan interest rates may continue during the process of reauthorizing the Higher Education Act. It is for that reason that our recommendations regarding federal student loan interest rates is included here.

**Guiding Principles:**

The National Direct Student Loan Coalition recognizes that there are multiple public policy implications for federal loan subsidies and interest rates. The following principles guide the interest rate proposal presented below:

- Interest rates must promote student access and completion
- Interest rates should be based on a formula that is permanent and provides a long term solution
- Interest rates should balance the costs to the federal taxpayers and to students
- Rates should flow in an equitable way for all borrowers—one cohort of borrowers should not subsidize another
- Rates should reflect the government's cost of borrowing plus a factor to cover loan servicing and an appropriate share of borrower benefits
- Variable interest rate should be adjusted on an annual basis and clearly disclosed to all borrowers
- Rate needs to be set in the context of the total cost of borrowing which include
    - Elimination of the origination fee
    - Interest subsidy
    - Loan forgiveness

**Recommendation:** We suggest the following interest rate structure based on these principles:

**Feature:** **The interest rate should be indexed to a treasury security.**

**Rational:** The rate on treasury securities reflects the government's cost of borrowing and recognizes that student loans are federal investments. A market driven rate keeps the rate fair to the borrower and taxpayer as the cost of capital fluctuates.

**Principle:** Promotes access by assuring the best rate possible and keeping interest rates relevant to market rates. Historical rates can indicate how rates might fluctuate during the life of the loan and provide assurances that are measurable.

**Feature:** **The index should include an amount that covers an appropriate portion of the cost of the program, allows for borrower subsidies, and reflects the variance in cost between borrowers who are enrolled and borrowers who are in repayment.**

**Rational:** Program costs are well documented and an index can be developed that includes an amount to cover an appropriate portion of the cost of the program and limits the liability of the taxpayer.

**Principle:** The appropriate index can balance the subsidies to the borrower with the cost to the taxpayer. Simplification could be achieved if the rate structure results in the right 'price' for a loan thus making other fees unnecessary.

**Feature:** **The rate on all loans should be market driven and adjusted annually.**

**Rational:** A rate that is adjusted annually on a fixed date protects the borrower and the taxpayer with costs that most closely reflect the cost of capital. It provides simplicity for the borrower since all loans will have the same rate. A true variable rate assures that all borrowers are treated equally. A rate that is variable but locked for each cohort of loans results in some borrowers being overcharged while others are undercharged. With market based fluctuations in the rate there will be no need to artificially adjust the rate through legislation.

**Principle:** A truly variable rate provides a long term solution that protects the interest of both the borrower and the taxpayer. It promotes persistence and completion because the cost of financing is market based and fair to all parties. Rates that adjust annually can be disclosed with certainty that the rate will exist for a year.

**Feature:** **To protect borrowers, consumer protections should be considered with a view toward the cost of these provisions and tradeoffs in risk. Options might include a cap on the amount interest rates can go up or down in a one year period (such as +/- 1 %), a cap on overall rates, and differentials between the various federal loans; subsidized, unsubsidized and PLUS/Grad PLUS.**

**Rational:** Consumer protections generally introduce added cost to the programs however a cap limiting annual fluctuations to +/- 1% can add a level of fairness to the rate, make changes in cost and revenue more predictable and deter the impulse to react legislatively to market behavior. While an overall cap may appear to be a more desirable protection for borrowers it may never be necessary and would add cost. Protecting the borrower from large fluctuations in monthly payments year to year may be more helpful to borrowers.

**Principle:** Though absence of a cap makes the rate truly market driven and avoids the temptation to legislatively change the rate during periods of volatility providing a basic consumer protection that sets some limit on rate fluctuations should be considered for its effect on access and persistence.

**Summary**

The interest rate for the federal loan programs should be a variable rate tied to a treasury security plus a factor to reflect the administrative cost of the program and subsidy for borrowers. The rate should vary annually on all of a borrower's outstanding federal loans with some consumer protections such as a limit on annual changes (for example +/-1 %). Additional loan fees should not be necessary if the rate correctly reflects reasonable subsidies and costs.

The rate structure suggested here supports the needs of student borrowers for adequate and necessary subsidies to promote the goals of educational access, persistence and program completion and the needs of taxpayers by providing adequate revenue to cover the appropriate level of cost and subsidies in the federal loan programs.

**Increase Undergraduate Loan Limits**

The current loan limits on Direct loans have been largely untouched since 2005. When loan limits on Stafford loans do not increase, students are forced to resort to much more expensive parent or private loans.

The National Direct Student Loan Coalition supports the idea of increases in loan limits. First year borrowers should have the ability to borrow at least $9,500 / year (an increase of $4,000 from the current limits) and after the first year, the limit should increase to at least $12,500. In order to accommodate these new limits, the aggregate undergraduate limit should be adjusted.

Schools that wish to limit borrowing should have that ability and be able to do so for individual cohorts within their population. For example, some low cost institutions, or institutions that can meet most of a student's need with non-loan sources, should have the statutory authority to limit annual borrowing for their students. Schools may use criteria such as year in school, or satisfactory academic progress to identify the populations who have their loan amounts limited.

**Allow Federal Loan Consolidation to All Borrowers at Least Once During Repayment**

Loan consolidation offers borrowers an opportunity to obtain benefits not available when their original loan was obtained, make management of loan obligations more reasonable by bringing all loans into a single note and sometimes allows the federal government to bring more loans under the 'federal direct' umbrella. Loan terms and interest rates can vary significantly depending on when the loan was originated. Allowing borrowers to consolidate once could allow borrowers to take advantage of more favorable terms or options not originally available. Limiting the number of times a borrower can consolidate will make the borrower more judicious about when to employ the option and limit federal liability from a constantly moving portfolio.

Building on the notion of a single portal for all loan services, we suggest utilizing StudentLoans.gov as the vehicle for borrowers to apply for loan consolidation. From this portal, borrowers can access their loan data on the National Student Loan Data System (NSLDS) and be presented with all their federal loans. A borrower could then select which loans they would like to include in a consolidation loan.

To support an informed consolidation decision we support adding functionality to StudentLoans.gov that would:

- Allow the borrower to access information about all their outstanding federal loans through NSLDS
- Allow the borrower to select all loans to be included in the consolidation
- Present the monthly payment amount for each of the repayment options available to the borrower based on the loans selected for consolidation
- Allow the borrower to select their repayment option for the consolidated loan
- Once the student has selected their repayment option, application information could be provided on-line and the borrower's rights/responsibilities and other legal requirements of the application process could be provided
- The borrower could then complete the promissory note with an electronic signature similar to that required of the Master Promissory Note under www.studentloans.gov.
- This on-line process could also be used to collect information from the borrower's various loan holders so that the Loan Consolidation Verification could be completed
- The borrower could be notified by the loan servicer once all of the original loans are paid in full with the consolidated loan
- The consolidation servicer then notifies the borrower of the completion of the process and initiates the repayment process

A limited option for loan consolidation, supported by an efficient, electronic application process, offers borrowers an opportunity to manage their federal loans and supports successful repayment.

**Eliminate the 150% of Program Length Limit on Eligibility for Subsidized Loans**

The recently enacted limit on eligibility for subsided federal loans to 150% of program length should be eliminated. Eligibility criteria for federal loans should follow the general eligibility criteria established for other Title IV financial aid programs. This helps to simplify the programs and allow potential recipients to make decisions about access and attendance based on their eligibility for support.

The following points are offered in support of this recommendation:

- Current Satisfactory Academic Progress requirements for the Title IV federal aid programs and cumulative loan maximums already limit the amounts students can borrow and length of eligibility.
- The additional limitation imposed by this regulation is not necessary and creates unnecessary program complexity for applicants.
- These requirements create costly monitoring and implementation processes, both for schools and the Department of Education.
- For students who change programs or find job retraining necessary, the provisions are especially punitive.
- The cost of federal subsidies should be managed through the appropriate pricing of student loans as a factor in the interest rate calculation not by creating regulatory complexities.
- This provision was enacted to affect scoring and create savings to pay for the extension of the 3.4% interest rate for subsidized loans for one year.

**Eliminate the Requirement that Loans for Students in the Last Term of Their Undergraduate Career Be Prorated**

If the loan proration requirement was enacted to reduce student indebtedness or encourage program completion sooner, data from the initial set of Experimental Sites could support the fact that these goals were not accomplished by this requirement. We suggest that:

- The required proration of loans for one-term graduating seniors is contrary to the goal of college completion and an unnecessary administrative burden for schools
- In a student's final term they should be subject to the same borrowing limits as all other students
- Students who graduate default at much lower rates than those who do not graduate

Additionally, federal student loan borrowing is already limited overall by aggregate and annual limits and further limitations are unnecessary. Restriction of federal loan eligibility in a student's final term may force a borrower into more expensive and more risky private borrowing.

Elimination of required loan proration will serve the needs of borrowers by continuing critical federal student loan access at a critical point in their educational career and the federal goal of program completion.

**Re-establish Bankruptcy Protections for Private Student Loan Borrowers**

Private student education loan debt has grown exponentially in the recent past and many students have borrowed in excess of what they are able to repay. Therefore, steps must be taken to reduce inappropriate and unwise student borrowing. The National Direct Student Loan Coalition proposes the following:

- Private education loans should regain bankruptcy protection. If this is done, we foresee the following improvements:

    a. Lenders will be more judicious when making decisions about extending credit for educational purposes, and loans will therefore be made to those who appear more likely to have the ability to repay the loans.
    b. When a borrower of an education loan encounters unforeseen difficulties in repayment, they may avail themselves of loan discharge in bankruptcy as a last resort.

- Instead of self-certification, schools should be required to certify student eligibility for private education loans, including assurance that the loan will not exceed Cost of Attendance minus other financial aid/education loans. This would prevent over-borrowing and borrowing private education loans for non-educational purposes.

**Eliminate Loan Forgiveness as a Taxable Event**

Income driven repayment options are included in the current repayment choices available to federal student loan borrowers. These options recognize that either through choice or circumstance, a borrower's income may be limited and thus affect the ability to retire federal student loan debt. We do not believe it was the intent of those who authorized these provisions to create an unreasonable tax burden for those who legitimately qualify for this benefit.

Though we recognize this change may need to be accomplished through the tax writing committees, we encourage the education committees to focus attention on this issue and consider the following:

- If a borrower, after years of reduced payments because of low income, still has a balance due, adding the forgiven amount to their taxable income would be a huge burden, creating tax liability that is beyond their capabilities to pay.
- The statute should be changed to mirror the Perkins Loan program in which forgiven loan amounts are not taxable.

**Create One Federal Loan Program within Title IV of the Higher Education Act**

The complexities in the federal student loan programs are overwhelming for students, parents, schools, and loan servicers. The inherent difficulties are the result of both legislation and regulation and result in confusion at best and unnecessary defaults at worst.

In order to streamline and simplify the federal student loan programs without adding significant cost to taxpayers, the National Direct Student Loan Coalition proposes that the Federal Direct Student Loan, and Federal Perkins Loan programs be dramatically changed. The result of the changes will be:

- Greater understanding of the terms and conditions of any federal debt students incurred, both during in-school periods and in repayment
- Simplicity of repayment resulting in a decrease in default rates
- Improvement in actual and perceived fairness of terms and conditions of federal student loans both from current and long-term perspectives

We understand that there have been a number of proposals as to how one federal student loan program could be accomplished and how it would work. There are numerous stakeholders who have varied interest in how one federal loan program could impact their eligibility, access to funds, administrative efforts and profits. We suggest that the interests that should guide the development of a single federal loan program be driven by the following:

- Assure that student borrowers have access to federal funds that support their educational goals
- Develop loan terms and conditions that support student success in educational attainment and loan repayment
- Avoid unnecessary legislative constraints and structure program requirements that support administrative capability for schools and the Department of Education
- Create a cost / benefit structure that supports taxpayers interests with investment in human capital

Members of the National Direct Student Loan Coalition are anxious to work with the Education Committees on this project.

Contact:

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[Questions submitted for the record and their responses follow:]

COMMITTEE ON EDUCATION
AND THE WORKFORCE
U.S. HOUSE OF REPRESENTATIVES
2181 RAYBURN HOUSE OFFICE BUILDING
WASHINGTON, DC 20515-6100



May 13, 2014

Mr. James Runcie
Chief Operating Officer
Office of Federal Student Aid
U.S. Department of Education
801 1st Street, NE
Washington, D.C. 20202

Dear Mr. Runcie:

Thank you for testifying before the Subcommittee on Higher Education and Workforce Training at the hearing entitled, *"Examining the Mismanagement of the Student Loan Rehabilitation Process"* on Wednesday, March 12, 2014. I appreciate your participation.

I have enclosed additional questions for inclusion in the final hearing record. Please provide a written response **no later than May 28, 2014**. Responses should be sent to Mandy Schaumburg or Jenny Prescott of the committee staff who can be contacted at (202) 225-6558.

Thank you again for your important contribution to the work of the committee.

Sincerely,

Virginia Foxx
Chairwoman
Subcommittee on Higher Education and Workforce Training

1. To date, will you please list the specific performance data requirements the department has put in place to ensure the department and its contractors are effectively serving these borrowers?

2. From listening to the GAO and IG testimony, it seems the department had to allocate a significant number of resources to the default management system to correct these problems and manage the work-arounds being developed. Can you quantify how many staff were pulled in to work on this issue and how much this cost the department in additional expenses?

3. How long does it take for a borrower's payment to show up in the system so both the department and the collection agencies know how many payments the borrower has made towards rehabilitation?

4. As of today, once a borrower has completed the loan rehabilitation process, how long does it take for a borrower's loan to be transitioned from the default management platform to the student loan servicing system? How long does it take for the borrower's credit to be cleared of the default?

5. The GAO report identified 80,000 borrowers who were unable to rehabilitate their loans when they became eligible. What are the potential harms that could occur to a borrower who has a loan in default? In other words, please describe the consequences to a borrower when their loan defaults.

6. When the department became aware of the default management system failures, why did it not reach out to the impacted borrowers instead of waiting for them to contact FSA before providing assistance?

7. In selecting a contractor to convert the default management system, the department chose to modify a contract for an existing contractor rather than bring in a new contractor to handle the project. The contractor selected had already demonstrated problems in other areas. Why did the department choose to modify this particular contract instead of selecting a contractor with no prior issues?

**Questions for the Record**
**Congressman George Miller**
**Subcommittee on Higher Education and Workforce Training Hearing**
**March 12, 2014**
**Examining the Mismanagement of the Student Loan Rehabilitation Process**

To James Runcie, Chief Operating Officer, Federal Student Aid

1. Please explain the specific steps FSA has taken, or plans to take, to mitigate risks associated with the contracting out of student loan servicing and other key functions of FSA's operations. Please distinguish between FSA's oversight of existing contracts and contracts FSA plans to make going forward. What legislative action, if any, does FSA recommend to enhance its ability to effectively oversee its operations and FSA's oversight of its contractors?

2. Please provide detailed information about the Department's use of its regulatory authority to improve borrowers' ability to successfully rehabilitate defaulted loans. How has regulatory action improved borrowers access to important loan repayment options, such as Income Based Repayment?

[Mr. Runcie response to questions submitted follows:]

**Questions for the Record**
**Subcommittee on Higher Education and Workforce Training**
**"Examining the Mismanagement of the Student Loan Rehabilitation Process"**
**March 12, 2014**

**Mr. James Runcie, Chief Operating Officer, Office of Federal Student Aid**

**1. To date, will you please list the specific performance data requirements the department has put in place to ensure the department and its contractors are effectively serving these borrowers?**

**Response:** The Department believes the best way to assist borrowers in rehabilitating their loans is to help them find the most effective way to resolve their debts. To that end the Department has created rehabilitation processes that match the various repayment plans in the non-default servicing area, and two separate consolidation processes. The private collection agencies (PCAs) used by the Department are required to follow specified protocols to ensure borrowers are aware of the various repayment options and are able to make an informed decision with regard to which repayment plan is the best option given their financial situation. Throughout this process our shared objectives are to treat the borrower with respect and to safeguard the interests of the Federal taxpayer by consistently improving the effectiveness of our collection efforts.

PCA base compensation and bonus payments are driven by their success in helping borrowers repay their loans, whether through traditional collection techniques or through loan rehabilitation, which returns borrowers to a regular repayment pattern and removes them from a default status. Accordingly, performance data primarily focus on the size and type of collections realized. The Department has instituted procedures with the PCAs on the various default processes we have created and there are consequences for not following the rules, up to losing some or all of the loans assigned to them for collection. Borrower complaints are also tracked to ensure we are aware when issues are raised. We believe this combination of incentives and disincentives, combined with ongoing oversight, effectively ensure that each PCA is acting in a manner consistent with the Department's goals.

**2. From listening to the GAO and IG testimony, it seems the department had to allocate a significant number of resources to the default management system to correct these problems and manage the work-arounds being developed. Can you quantify how many staff were pulled in to work on this issue and how much this cost the department in additional expenses?**

**Response:** While addressing implementation issues was a major focus for FSA during 2011-12, no additional staff resources were deployed on this effort beyond those that normally work on default collection activities. Staff costs did not increase as a result of Debt Management and Collection System (DMCS) issues because a number of Department staff perform oversight work with DMCS on a daily basis as part of their normal duties; for much of late 2011 and 2012 many of these employees were required to change their normal work processes as a result of system functionality issues. Implementation issues resulted in DMCS being a significantly greater focus of management attention than would normally be the case, but again this did not result in any additional staffing expenses to the Department.

While GAO and the IG noted that Department staff was required to find "workarounds" to properly account for rehabilitations, as noted above, we did not incur additional costs due to this work. In fact, as a result of poor performance issues, the Department reduced payments on the Xerox contract by $11 million.

3. **How long does it take for a borrower's payment to show up in the system so both the department and the collection agencies know how many payments the borrower has made towards rehabilitation?**

Response: The borrower's payment will show up in DMCS within approximately one business day and in the PCA's system by two business days from when it is posted in the DMCS. More specifically, individual borrower payments are made to a lockbox operated by the Department of the Treasury; we receive payment files from the lockbox contractor on a daily basis. Payments are processed by the lockbox contractor on the day they are received and the borrower is given credit for the payment as of the date the lockbox contractor received the payment. All payment transactions that have been processed are reported to the PCAs five times per week. The file PCAs receive is called the Daily Financial File, which has all financial transactions at the individual borrower level since the last time the report was run.

**4. As of today, once a borrower has completed the loan rehabilitation process, how long does it take for a borrower's loan to be transitioned from the default management platform to the student loan servicing system? How long does it take for the borrower's credit to be cleared of the default?**

Response: Approximately 75 percent of borrowers who have completed the requirements for loan rehabilitation have their loans transferred to a non-default servicer within a week of their last qualifying payment. The other 25 percent may take from two to three weeks to be transferred depending on the timing of certain manual processing. This is a significant improvement over processing times in the previous default system, which typically took at least a month to transfer rehabilitated borrowers to the servicing system.

The Department updates the credit bureaus once a month with the latest status for all 4.9 million borrowers currently on DMCS. Since we are performing rehabilitations on a weekly basis this means updated borrower credit information is sent to credit reporting agencies anywhere from one to four weeks from the time of the borrower's last qualifying payment.

**5. The GAO report identified 80,000 borrowers who were unable to rehabilitate their loans when they became eligible. What are the potential harms that could occur to a borrower who has a loan in default? In other words, please describe the consequences to a borrower when their loan defaults.**

Response: There are a number of negative consequences when a borrower defaults. These are outlined in the promissory note, mandatory entrance and exit counseling, and supplementary materials provided by schools, the Department, and loan servicers. They are also spelled out repeatedly in due diligence materials sent by the borrower's servicer during the delinquency period leading up to a default, as well as on the Federal Student Aid (FSA) website. These consequences are listed below, along with steps taken by the Department to mitigate these impacts for borrowers eligible for rehabilitation during the period when DMCS was experiencing implementation issues.

- Loss of eligibility for Title IV aid (The Department set up Borrower Relief processes to restore Title IV eligibility for borrowers who completed their rehabilitations.)

- Adverse credit (The Department set up Borrower Relief processes to modify the credit reports for borrowers who completed their rehabilitations.)
- May be charged collection fees (Many collection fees are forgiven for borrowers who successfully rehabilitate or consolidate their loans out of default.)
- Loss of access to flexible repayment plans (The Department set up Borrower Relief processes to give borrowers relief from their monthly payments if they had a change in their financial situation. For example if a borrower lost their job, their monthly payment could be reduced to zero.)

**6. When the department became aware of the default management system failures, why did it not reach out to the impacted borrowers instead of waiting for them to contact FSA before providing assistance?**

Response: Borrowers impacted by the issues generally were in contact with PCAs and could receive information on their specific situations from them. In addition, borrower issues related to delays in services such as rehabilitations were primarily associated with specific circumstances such as the need to re-establish eligibility for Title IV aid or to re-establish a positive credit history in preparation for a major purchase. The Department had no way of knowing which borrowers were experiencing these circumstances and believed the most effective way to focus resources was to have borrowers contact us directly. As a result, the Department set up Borrower Relief processes that were given to all PCAs and the Department's Call Center contractor. In addition, many of the system issues did not have a direct impact on borrowers and the Department believed that resources would be better focused on directly addressing the issues themselves rather than on outreach. As stated earlier, the PCAs were in direct contact with their borrowers and were able to provide them information as they received it from the Department.

**7. In selecting a contractor to convert the default management system, the department chose to modify a contract for an existing contractor rather than bring in a new contractor to handle the project. The contractor selected had already demonstrated problems in other areas. Why did the department choose to modify this particular contract instead of selecting a contractor with no prior issues?**

Response: The Department based its decision on several factors, including the vendor's extensive expertise with student loan default collection processes and requirements and their proposal to leverage a recognized commercial accounts receivable system had been used successfully by other major private and public sector credit organizations. The Department believed these factors indicated a strong likelihood of success and believed that, in combination with the ability to implement a new system at no additional cost to the government, this represented the best value to the government and the taxpayer.

**Questions for the Record**
**James Runcie, COO, Federal Student Aid**

**House Committee on Education and the Workforce**
**Hearing – March 12, 2014 re: FSA Defaulted Loan Management**

**Questions from Congressman George Miller**

**1. Please explain the specific steps FSA has taken, or plans to take, to mitigate risks associated with the contracting out of student loan servicing and other key functions of FSA's operations. Please distinguish between FSA's oversight of existing contracts and contracts FSA plans to make going forward. What legislative action, if any, does FSA recommend to enhance its ability to effectively oversee its operations and FSA's oversight of its contractors?**

Federal Student Aid (FSA) is committed to ensuring that borrowers receive the highest quality service, and we carefully oversee our contractors, including loan servicers and private collection agencies, to make sure they meet our expectations. The Department's oversight staff closely tracks portfolio performance data, monitors phone calls, reviews correspondence, analyzes financial reports, and reviews and approves deliverables for all servicing and Private Collection Agency (PCA) contracts. FSA also designates federal Contracting Officers, Contracting Officer's Representatives, and liaisons for each servicer and PCA that works with each contractor to discuss and resolve issues.

In addition to regular and thorough oversight, we are constantly looking for ways to improve the incentives for performance and protections for borrowers that we can build into our contracts. For example, earlier this year, President Obama directed FSA to revisit the terms of our student loan servicing contracts, in particular our contracts with our Title IV Additional Servicers (TIVAS). As a result, in September, we announced new pricing and performance structures for our servicers. These changes are structured to create additional incentives for servicers to keep borrowers in good repayment status and able to manage their debt, including higher compensation to servicers who keep their borrowers in good repayment status and effective counseling and outreach so borrowers select the best repayment option for their circumstances. These incentives include a payment structure that pays servicers more for every borrower in a current repayment status, and less for borrowers who are delinquent, in deferment or forbearance, or in default. The changes also include changes to the allocation formula for new loans to give more weight to customer satisfaction ratings. The changes also include additional incentives for servicers to focus dedicated resources and enhanced outreach and information efforts on military servicemembers with student loans.

The Department has announced its intent to re-compete our servicing contracts in Fiscal Year 2016. This will allow us sufficient time to evaluate the effectiveness of the September terms and prepare for a fair and robust competition.

Finally, working with the Office of the Inspector General, FSA has strengthened the oversight of both our existing and new contracts. For example, FSA has implemented a new contract for the Debt Management

Collection System (DMCS). This new contract includes improved security utilizing the most recent federal security standards including two factor authentication tokens; contains performance metrics to ensure data quality and reporting; and follows best business practices as defined in the FSA life cycle management methodology. Additional oversight and monitoring is implemented through the use of independent verification and validation (IV&V). The Department will continue to improve its oversight of our contractors to ensure that borrowers receive the highest quality service.

**2. Please provide detailed information about the Department's use of its regulatory authority to improve borrowers' ability to successfully rehabilitate defaulted loans. How has regulatory action improved borrowers' access to important loan repayment options, such as Income Based Repayment?**

The Department has significantly simplified and streamlined the process through which borrowers rehabilitate defaulted student loans. On November 1, 2013, the Department published final rules that standardized and simplified the process for determining the reasonable and affordable monthly payment amount for a borrower who wants to rehabilitate a defaulted Direct Loan or FFEL program loan. The regulatory changes ensure consistent treatment of all defaulted borrowers and make it easier for borrowers to successfully rehabilitate their defaulted loans. Specifically, the initial reasonable and affordable monthly payment amount that must be offered to a borrower is set at 15 percent of the borrower's annual discretionary income, divided by 12, with a potential minimum payment of $5. This is the same formula used to determine a borrower's monthly payment amount under the Income-Based Repayment (IBR) Plan, which is available to most borrowers after they have successfully rehabilitated their defaulted loans. If a borrower objects to the monthly payment amount based on this formula, the payment is recalculated based on the borrower's disposable income, family size, and reasonable and necessary expenses, as determined based on information the borrower provides on a standardized form approved by the Department.

In addition, on November 1, 2012, the Department published final regulations establishing the Pay As You Earn (PAYE) Repayment Plan. These regulations made a lower income-based payment amount and a shorter period of repayment to qualify for loan forgiveness available to some borrowers earlier than the July 1, 2014 effective date for these same changes made in the 2010 SAFRA Act. The regulations also modified the rules governing the IBR Plan and the Income-Contingent Repayment (ICR) Plan, to make them more transparent and consistent on income documentation requirements and the loan forgiveness process.

This past June, President Obama directed the Department to prepare new regulations that will make PAYE available to all Direct Loan borrowers, making millions of additional borrowers eligible for the more generous terms. On September 3, 2014, we published a notice in the Federal Register announcing our intention to form a negotiated rulemaking committee in the coming months and anticipate that these benefits will be available to borrowers in late 2015.

Regulatory action combined with significant targeted outreach to current borrowers has increased in the number of borrowers choosing income-driven repayment plans. Nearly 13 percent of all borrowers in repayment are enrolled in some form of an income-drive repayment plan. For example, as of June 30, 2014, 1.7 million borrowers were enrolled in the IBR plan, representing $91.2 billion in federal student loans, compared to approximately 900,000 enrolled borrowers representing $50.9 billion in federal student loans one year ago.

In addition, as of June 30, 2014, there were 260,000 borrowers participating in the PAYE repayment plan representing $9.8 billion in federal student loans, a more than six-fold increase from the 40,000 borrowers representing $1.3 billion in federal student loans enrolled in the plan one year ago. And approximately another 600,000 borrowers are participating in the Income Contingent repayment plan representing $20.3 billion in student loans.

The Department will continue to use our regulatory authority and all tools at our disposal to improve repayment options for borrowers and ensure that borrowers are aware of their options and that they are able to manage their debt.

[Whereupon, at 3:38 p.m., the subcommittee was adjourned.]