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[Student Loan Rates] [2]

Stack:	Row:	Section:	Shelf:	Position:
S	15	1	11	1

(Laura)

D.C. Stg Comm 9/18/98

. Program -
-Make sure aren't problems,
w/ a flood...

- Talked to Univ. Rabbi - go out on [illegible] basis, act as lenders

Longstan Univ help D.C. - banks say because
exposure to admission...

- mg., cust. svc., etc - used to be able to
make the case, but not any more..
banks go to [illegible], etc.

. Dean: Ex. Bills out from - yes - automatic
Loan app from [illegible] → Career [illegible]
FR Career income (1% ??)

"Keystone [illegible] Cp"

* (Need to do study of cost.)
CBO, NPV

To summe -
-Need to grow
-need marketing...
- More support - cust. service care. - no cutter the pressure.

- w/o the OL cooperation - FERC sanctions / agencies will lose monopoly...

- G.A. use of reserves & key computer systems, etc...

* 25,000 @ 7-8% in fdn. aid.
  : No emergency loans needed

* PROGRAM has gone well - now to get the news out...

- Add.

* MARKETING - specific stories
  - AA EASPL prospects...

(- policies of accepting funds from vendors, etc.)

☐ OL core group mtg w/ CEO

Long. said 3-5% growth in OL as goal (?)

☐ Regional V.A. mtgs - need the names & attend.
  -mla. : not just the tiny towns...

UNITED STATES DEPARTMENT OF EDUCATION

Office of the Deputy Secretary
600 Independence Avenue, SW
Washington, DC 20202

Telephone Number: (202) ______ Fax Number: (202) 401-9027

FAX COVER SHEET

TO: Maureen McLaughlin, Jaime Lizarraga, Diane Rogers, Don Feurstein, Bob Shireman

ORGANIZATION:

PHONE: FAX:

FROM: Kristi Kimball

COMMENTS:

FYI - More evidence lender subsidy = excessive.

TOTAL PAGES (Including Cover): 3

The Princeton Review Announces

New Stafford Loan Rebates to Students

The Princeton Review, a lender participating in the Federal Family Education Loan Program (OE # 832222) has announced that it is providing a one-percent (1%) rebate of the total amount borrowed to students at selected schools who take out Stafford Loans from The Princeton Review. This benefit is in addition to the many current benefits students derive from having their Princeton Review Stafford Loans serviced by Sallie Mae.

Benefits that borrowers can now receive with a Princeton Review Stafford Loan include:

- One-percent (1%) rebate on outstanding loan balances 60-days prior to repayment.
- Two-percent (2%) interest rate reduction if the borrower makes the first 48 payments on time.
- Refund of all but $250 of the borrower's origination fee if the Stafford Loan exceeds $8,333.
- ¼-percent (0.25%) interest rate reduction if the borrower automatically transfers payment from the borrower's checking account.

Since the new one-percent (1%) rebate will be paid 60-days prior to repayment of the loan, students will have the option of either applying the rebate to the first several monthly payments or receiving the rebate in the form of cash and using the proceeds for other purposes. We believe that providing the additional benefit at a time when loans initially enter the repayment phase helps students to get off on the right foot in meeting their financial obligation.

We would like to offer this benefit to students attending your college. Please contact Michael Blattman, Vice President, at 301-918-4587 or email at MikeB@Review.com.

V-Tek to Offer a Student Loan Origination System

For Immediate Release
Monday, September 21, 1998

Contact: Bernard Abrams
V-Tek Systems Corporation
909-396-5355

Diamond Bar, California — V-TEK Systems Corporation, a software development and system integration company, today announced plans to offer a student loan origination system. Additionally, they said negotiations with a major student loan industry participant as a joint venture partner were near completion. The new system - which has been in development since April of this year, will support both Internet and Intranet communications and will rely on leading-edge technologies to deliver a truly flexible, modern architecture. System software includes Windows NT 4.0, Oracle 8, Visual Basic, AV-Image, Microsoft Internet Server and MS Office.

According to Bernard Abrams, CEO of V-Tek, "A state-of-the-art loan origination system is long overdue in the education finance industry. Over the past several years, both commercial and in-house developed systems have been retrofit or front-ended, but the basic technology is outdated. The simple reality of today's financial aid environment is the demands of the schools and students for information support, data base access and funds delivery have far surpassed the capabilities of any existing software."

V-Tek's interest in developing a student loan origination system has evolved over the past three years. During that period the company created, and now manages, the student loan industry's first large-scale data switch for ELM Resources, an alliance of educational lenders. V-Tek developed the software schools and lenders use to interface to ELM's data base services, which is entirely built around Internet browser technology. This software was one of the nation's first transactional business applications to run on the Web. V-Tek also implemented the financial aid industry's first Web status service for student loans for ELM Resources and the first Web status service for grants for Illinois Student Assistance Corporation (ISAC). In addition, several large lenders use V-Tek developed data servers for sending and receiving student loan data files.

"Given all of the experience we've had building student loan delivery and data base products, it's a natural progression to get involved with originations," says Abrams. "The work over the last few years has given us a unique insight into the needs of schools and lenders relative to student loan processing. We plan to put all we've learned into the new system."

System modules will include imaging/workflow, credit bureau interface, pre-approval processing, Web status access, Web transaction processing and school-selected disbursement flows (funds request, netting and date driven). The system will support Stafford, PLUS and Alternative loans.

Related to the loan origination development project, V-Tek said Seneca Technologies, Inc., a Long Beach, California based consulting firm, is being used to develop the user requirements for the system and perform the project management function. Seneca will also help market the product to institutions who make student loans.

V-Tek Systems Corporation, headquartered in Diamond Bar, CA, is a software development and system integration company with extensive expertise in client/server technology, Unix and NT operating systems, Oracle data base software and Internet communications. V-Tek provides software solutions and services to many of the nation's largest financial institutions and colleges and universities.

hension. The New River project has installed furnaces, insulation, windows, and roofs in more than a dozen turn-of-the-century homes that had not been built to withstand the state's harsh winters.

"If we had to rely on regular volunteers' showing up every mo… wouldn't stay glued … David, director of the … "People just can't tak… their lives to renovate

inevitable next remark was, "What is AmeriCorps?"

It's not the question President Clinton would have anticipated, five years after he …

response to budget cuts and Congressional critics who charged that AmeriCorps was trying to displace local volunteer groups. As a result … …s official says. …orps who don't …-relations and re… …riCorps is $3-mil… 2.5-million for the … third of the size of

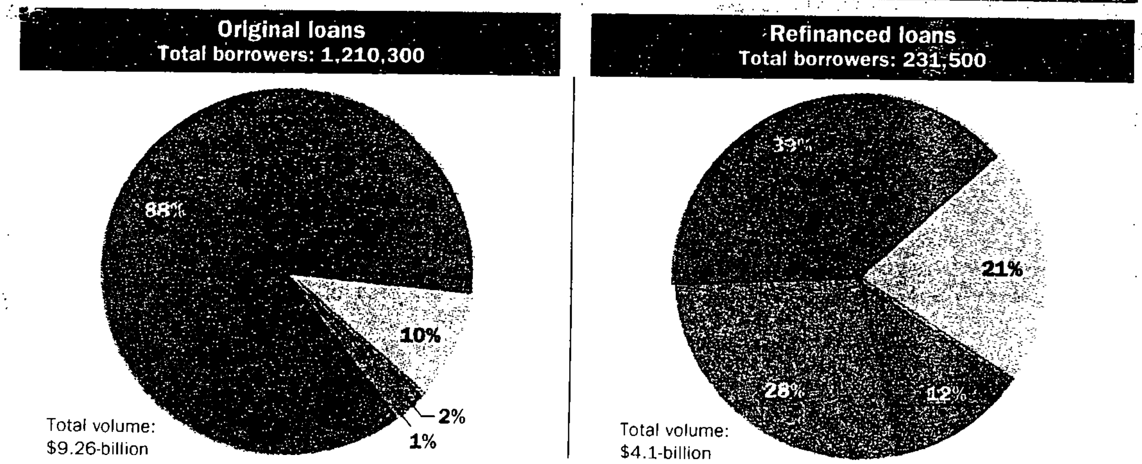
…students to go into the public sector after … grams that gi… …ice as a way of life.

★ **Join a debate** on the issues raised in this article in the "Colloquy" section of *The Chronicle*'s World-Wide Web site at: *http://chronicle.com/colloquy*

Few Borrowers Repay Student Loans Through 'Income-Contingent' System

BY STEPHEN BURD

How Borrowers Repay Direct Student Loans



Repayment Plans in the Direct-Loan Program

Standard repayment: Students pay a fixed amount each month until their loans are repaid, in 10 years.

Graduated repayment: Students' monthly payments start low, then rise every two years until the loan is repaid in 15 years.

Extended repayment: Students pay a smaller fixed amount each month, and repay their loans over 12 to 30 years, depending on the amount they owe.

Income-contingent repayment: Students' monthly payments are based on their annual income and the amount they owe. After 25 years of repayment, the loan is discharged by the federal government.

Note: Figures may not add to 100 per cent because of rounding.

SOURCE: U.S. DEPARTMENT OF EDUCATION

CHRONICLE CHART BY SHERRIE GOOD

LESS than 1 per cent of new student-loan borrowers in the Clinton Administration's direct-loan program are paying off their loans under the program's "income-contingent repayment" option.

That is a far cry from the campaign promises that Mr. Clinton made in 1992, when he contended that tying borrowers' loan payments to their future income would make it easier for hundreds of thousands of students from low-income families to go to college.

As part of a broader reform of the federal financial-aid system, Mr. Clinton proposed during his initial run for the Presidency that student loans be payable either as a percentage of a person's income or through community service.

"We will open the doors of college to high-school graduates without regard to income," candidate Clinton said repeatedly on the campaign stump. "They could borrow the money and pay it back as a percentage of their income or with a couple of years of service to our nation here at home."

Clinton aides believed that income contingency—an idea first advocated by the economist Milton Friedman in a 1955 essay—would make borrowing less threatening to needy students because they would have to pay back only a percentage of their future earnings. Under the plan, such students would have nothing to fear, because if they earned little, their payments would be small, and if they failed to pay off their loan debt, it would be forgiven after 25 years by the government.

Mr. Clinton also believed that income contingency would make it easier for students to pursue careers in low-paying but socially useful fields, such as teaching.

But after four years in operation in the direct-loan program, the income-contingent repayment option has failed to revolutionize student borrowing. Its low level of use so far suggests that it has not played a major role in increasing access to college or altering the career path for many student-loan borrowers.

Instead, the Education Department and financial-aid officials at colleges in the direct-loan program have sold income contingency mostly as a "last resort" option for needy students with sizable debts who have defaulted or are close to defaulting on their loans.

Mr. Clinton's ambitions for income contingency have been stymied primarily because the repayment option is wedded to the controversial direct-lending program.

In 1993, the President hoped to replace the guaranteed-loan program with direct lending, which provides loan funds directly to students through their colleges, bypassing the banks that dominate the traditional loan system.

But Congress, skeptical about the government's ability to manage a huge loan program, slowed the transition. Now, in its fifth year, direct lending has captured only a third of the total student-loan volume. As a result, income contingency is available at only about 20 per cent of the nation's colleges.

In their effort to limit the growth of direct lending, banks and guarantee agencies have vigorously opposed the income-contingent repayment option, which they have feared would give the direct-loan program a competitive edge.

Three groups that represent the *guaranteed-loan industry*—the Coalition for Student Loan Reform, the National Council of Higher Ed-

She recommends income contingency only "as a last resort," to the most desperate borrowers.

Surprisingly, Education Department officials share her views. They have used the program mainly as a way to rehabilitate loan defaulters, or to stop people who are close to default from going under. Typically, the department encourages those borrowers to refinance their multiple loans into a single, new direct loan and to repay it using the income-contingent plan.

A General Accounting Office study last year on the income-contingency program found that about 40 per cent of all borrowers in the program at the time had been placed in it by the department after defaulting on guaranteed loans.

PROTECTION FROM SANCTIONS

The G.A.O. also found that users of income contingency default at a rate three times as high as borrowers using the other repayment options available in direct lending.

David A. Longanecker, Assistant Secretary for postsecondary education, says that even if some are defaulting again, the department's practice of placing them in the income-contingency program is invaluable because it helps rehabilitate many other borrowers.

"People who default mostly don't have the means to pay back their loans," Mr. Longanecker says. Income contingency, he adds, makes it easier for them to repay their loans until they find steady jobs, and protects them from the severe sanctions they otherwise would endure as defaulters.

Proponents of income contingency generally agree that rehabilitating defaulters is a worthy goal for the program. But they fault the department for not more aggressively fighting the efforts of lenders to discredit income contingency.

"There are millions of people who are struggling to pay back their loans and want to pay back their loans, but don't know about this option," says Leo Kornfeld, a former Education Department official who championed income contingency. "If a lot more people knew about it, a lot more people would be using it and not defaulting in the first place." ■

Education Finance Council—produced a report in November 1996 attacking income contingency as too costly to students.

Under the program, the report warned, a borrower's payments could be so low—as little as $5 a month—that they would not cover the cost of the accumulating interest. As a result, the total amount of money that the borrower would have to repay would soar.

'$10,000 IN INTEREST COSTS'

According to the report, a student who graduated with $15,000 in education debt and whose initial earnings were $15,000 a year would end up, after 25 years, repaying more than $36,000—and still fail to pay off the loan. The same borrower, the report said, could have chosen a 15-year graduated-repayment plan in the guaranteed-loan program, which allows payments to rise steadily over the life of a loan. Such a decision could save the borrower "approximately $10,000 in interest costs," the report said.

The report circulated widely among lawmakers and college officials. John Dean, counsel to the Consumer Bankers Association, believes that the report was "remarkably effective" at discrediting income contingency. "As a result of that report, I believe aid administrators became much more wary of recommending that option to their students," he says.

Sheryl T. Spivey is wary. "It is not something I want to recommend," says the director of student financial aid at the University of Minnesota–Twin Cities, a university in the direct-loan program. "It can double or even triple the cost of a loan."

Status of Loan Consolidation Applications Received by EDS Since December 1, 1997		
Number of Consolidation Applications[1]	**Cumulative Through 08/21/98**	**Change Since Last Bi-Weekly Report (08/07/98)**
Accepted	88,416	+6,588
In Process[2]	20,440	+1,002
Step 1: Obtaining lender information	10,560	+1,826
Step 2: In underwriting process	1,732	-590
Step 3: Obtaining signed promissory note from borrower	5,967	+1,341
Step 4: In ICR Process[3]	2,181	-1,575
Deactivated	7,577	+566
Ineligible/Withdrawn	2,529	-96
Completed (Consolidated)[4]	57,870	+5,116

- Applications continue to move through the consolidation process smoothly. EDS is expected to complete loan consolidations within 60 to 90 days. Therefore, we expect EDS to have about 60 to 90 days' volume of applications in process at any time. This is indeed the case. About 95 percent of the applications in process were received in the last 90 days (excluding " supplementals," which have already been consolidated -- see notes 2 and 4 below). Nearly all of the remaining five percent of applications in process either had been temporarily deactivated while EDS was awaiting additional information from the applicant or are in the extra step for income contingent repayment.

- An accepted application can be deactivated at any stage in the process if a borrower who has provided incomplete information fails to respond within 21 days to a request for additional information. The application is reactivated when the borrower provides the requested information.

- The change since the last bi-weekly report can be negative if more applications move to the next step than entered a step.

The figures include only applications that have been reviewed and accepted as complete.

2 Applications "In Process" include 771 supplementals, applications for which the loans have been consolidated (booked) but the borrower has requested within 180 days of the first booking that an additional (supplemental) loan be added to the consolidation loan. This break-out of supplementals reflects a recent enhancement in our reporting capabilities, which allows us to provide a more accurate picture of the loan consolidation process.

3 These are applications for borrowers who have selected or have been assigned the Income Contingent Repayment (ICR) option and are awaiting the approval of the waiver from the IRS or receipt of alternative documentation from the borrower.

4 "Completed (Consolidated)" applications do not include 771 supplementals, applications that have been consolidated but the borrower has requested that an additional loan be added to the consolidation loan. (See note 2 above.)

U.S. Department of Education
August 25, 1998

UNITED STATES DEPARTMENT OF EDUCATION

THE DEPUTY SECRETARY

AUG 21 1998

Honorable James M. Jeffords
Chairman, Senate Committee on Labor and Human Resources
835 Hart Senate Office Building
Washington, DC 20510

Dear Chairman Jeffords:

On July 29, 1998, you wrote to Secretary Riley regarding the Direct Consolidation Loan program. On August 10, 1998, I provided an initial response to your questions on Secretary Riley's behalf. Today, I am providing the remaining information you requested. An identical letter is being sent to Chairman Jeffords.

Before I address your numbered requests for information, I would like to stress that President Clinton, Secretary Riley, and I believe that the best interests of students, their families, and taxpayers are served by continuing two strong loan programs and leveling the playing field between them to the extent feasible through further changes in the law. I look forward to continuing to work with you toward this goal.

The Administration took a step in this direction by including in our proposal for the reauthorization of the Higher Education Act (HEA) a reduction in the interest rate on FFEL consolidation loans that is the same as that being offered on Direct and FFEL student loans, as well as Direct Consolidation Loans. We urge that the final HEA legislation ensure that consolidation loan borrowers in both programs receive the same low interest rate currently applicable to Direct Consolidation Loans and that lenders receive a rate of return that is comparable to what they receive on consolidation loans under current law.

Answers to your specific questions follow.

1. **The status reports currently provided by the Department include only applications which have been determined to be complete. What is the total number of applications that are received from borrowers during each reporting period?**

As you note, the Department's biweekly reports to Congress include only those applications that have been reviewed, determined to be complete, and therefore "accepted" by the Department's loan consolidation contractor, Electronic Data Systems, Inc. (EDS). These applications include all the information necessary for EDS to begin processing the application. Because EDS cannot process incomplete applications, we believe that this is the most accurate way to report this information.

Nevertheless, in response to your request, we are enclosing with this letter a table that indicates the total number of applications received during each biweekly period since December 1, 1997. This table includes both complete applications received by EDS as well as applications that are not complete for various reasons (such as a missing lender name or borrower address). This table does not include applications that were reviewed in the EDS mailroom and immediately returned to the borrower because they were missing certain vital pieces of information, such as a social security number or a signature. Once these latter applications are revised and returned by the borrower, they are treated as received and dated based upon the date of receipt of the returned, revised application.

As noted above, received applications are not officially "accepted" until they are reviewed, determined to be complete, and entered into the EDS processing system. EDS has accepted over 95 percent of the applications it has received since December 1, 1997. (This figure excludes applications rejected by the EDS mailroom and not yet resubmitted by the borrower, since those applications will be dated once they are returned by the borrower.) EDS currently has about 2,400 applications -- a number equal to about three or four days of receipts -- that are in the standard process of moving from received to accepted applications. During this process, EDS examines each application, resolves any miscellaneous data issues, and enters the application into the EDS processing system. As for the remaining 800 applications that have not yet been accepted, EDS has requested missing information from the borrower and is waiting for their responses.

2. **The reports indicate that more than 2,000 borrowers have withdrawn their applications. Why are these borrowers withdrawing from the program?**

The biweekly reports list application withdrawals, ineligible applications, and cancellations together. In fact, only about 400 of the roughly 81,800 borrowers who have applied for a Direct Consolidation Loan since December 1, 1997, have actually withdrawn their applications.

Many of the roughly 2,600 borrowers in the "Ineligible/Withdrawn" category on the August 7, 1998, were cancelled by an EDS customer service representative. For example, an application is cancelled if the borrower previously filed a duplicate application or if EDS could not locate the borrower in three attempts following the return of EDS correspondence that could not be delivered. If the reason for the deactivation is subsequently resolved (e.g., the borrower contacts EDS), than EDS reactivates the cancelled application and completes the consolidation.

The remaining applications among the 2,600 listed as "Ineligible/Withdrawn" were ineligible for a Direct Consolidation Loan. For example, borrowers cannot consolidate a student loan received through the Perkins or Health Education Assistance Loan (HEAL) programs unless they are also consolidating at least one loan from the Direct Loan or the Federal Family Education Loan (FFEL) programs.

According to EDS's customer service representatives, borrowers withdraw their applications for many reasons: borrowers decide to pay off their loans immediately; couples decide to halt their joint consolidation in order to consolidate separately; or borrowers' spouses will not give EDS permission to obtain income information from the Internal Revenue Service, among other reasons.

3. **The reports indicate that approximately 6,800 borrowers have had their applications deactivated. Last year deactivations were attributed in large part to incomplete applications. What is the reason for these deactivations and how does this rate compare with the FFEL program?**

A borrower's application is deactivated if he does not respond to a request for a vital piece of information or return his promissory note within 21 days. If the borrower responds after the application is deactivated, EDS reactivates the application and completes the consolidation. EDS has reactivated and consolidated roughly 8,200 applications that were received since December 1.

If the borrower does not respond within 120 days of the deactivation -- that is, almost five months after the original request -- the application will no longer be automatically reactivated upon borrower response.

Most deactivated applications are deactivated because the borrowers did not return their promissory notes. Other applications are deactivated after EDS discovers that one of the original loans is defaulted and the borrower does not return EDS's request for instructions on how to proceed. Other deactivations are caused by parent borrowers or their endorsers not responding to EDS's request for credit history information for parent (PLUS) consolidation loans or by a borrower entering income-contingent repayment who did not provide EDS or the Department with the ability to verify his income.

It is difficult to compare EDS's deactivation rate with the rates of FFEL lenders, as you request, because loan consolidation processes differ widely from lender to lender. For example:

- Some FFEL consolidators will cancel a borrower's application and require him to re-apply if he does not respond in 60 days, while others maintain the application indefinitely. EDS, which waits nearly five months before canceling an application, appears to be well within the range of time periods among FFEL consolidators.

- Unlike EDS, some FFEL lenders do not have a comparable deactivation status but simply cancel the application if the borrower does not respond; and

- Unlike EDS, some FFEL consolidators combine the application with a promissory note and therefore require fewer interactions with the borrower.

4. How long, on average, does EDS require to consolidate a student loan? What is the "age" of loans contained with the current backlog?

The Department tracks the processing time of "fast track" and "regular" applications separately. Prior defaulters who have re-entered repayment and whose loans are held by the Department's Debt Collection Services are consolidated through the fast track process because the Department already owns their loans.

To answer your first question, EDS completed a total of roughly 52,500 consolidations between December 1, 1997, and July 31, 1998. Of these loans, EDS completed fast track applications in an average of 13 days and regular applications in an average of 56 days. This is faster than the 60 to 90 days that the Department expects EDS to require to process an application.

To answer your second question, there is no "backlog" of consolidation applications, as discussed more fully in my August 10 letter to you. The roughly 550 fast track applications in process on July 31 have been in process an average of three days. The roughly 16,600 regular applications have been in process an average of 30 days.

It should be noted that these figures do not include 1,411 "supplemental" applications for which the loans already have been consolidated (booked), but the borrower has requested within 180 days of the consolidation that an additional (supplemental) loan be added to the consolidation loan.

5. What efforts are being made to ensure that borrowers do not become delinquent on their student loans while waiting for the loan consolidation process to be completed?

In its written materials, EDS prominently states that all applicants must continue to make monthly payments on their original loans while their application is being processed, unless they were not required to make payments prior to applying for a loan consolidation. EDS also notifies applicants that they may be eligible for deferment or forbearance if they are having difficulty making these payments and encourages them to contact their lender for further information.

For example, the second and third pages of the application packet consist of a letter to the borrower describing the consolidation process. The letter reads in part,

> If you currently are required to make payments on your loan(s), continue to do so. You will need to continue making payments until you receive written notification that your loan(s) has been successfully consolidated. If you are having difficulty making payments on your loan(s), contact the correspondence address or telephone number on your current loan statement(s) to find out ways you might be able to postpone loan payments; ask specifically about your "deferment" or "forbearance" options.

This paragraph is repeated in the promissory note package and correspondence that EDS mails to applicants to request additional information.

In addition, EDS's customer service representatives provide borrowers with information about their deferment and forbearance options. They also routinely refer direct loan borrowers directly to the direct loan servicing center, where they can obtain information about deferment and forbearance options.

6. The contractor has maintained a backlog of 17,000+ applications for the past four months. When do you anticipate that this backlog will be eliminated?

These applications are not a "backlog" as you describe it, as I explained in my August 10 letter to you. EDS is expected to complete loan consolidations within 60 to 90 days and, therefore, we expect EDS to have about 60 to 90 days' volume of applications in process at any time. This is indeed the case.

About 94 percent of the applications in process on July 31 were received in the last 90 days (excluding supplemental loans, as explained in response to question four above). Nearly all of the remaining six percent of applications in process either had been temporarily deactivated while EDS was awaiting additional information from the applicant or are now awaiting the verification of income and other information before the borrower can begin the income-contingent repayment plan.

Naturally, as the number of applications increases, the number of applications that EDS will have pending within the normal processing time of 60 to 90 days -- and thus the number of applications listed as "in process" on the biweekly reports -- will also increase.

7. What volume of Direct Loan Consolidation applications do you anticipate receiving each month over the next six months? How many direct loan consolidations do you expect your contractor will complete each month over the next six months?

As I described in my July 28 letter to Chairman Goodling (which I have provided to you) and the Department reported in its biweekly reports, there has been an increase in volume of Direct Consolidation Loan applications. Although there may be a further increase in application volume, changes in volume are difficult to predict.

Past anticipated increases in volume have not always materialized. For example, the Department anticipated an increase in loan consolidation volume in the fall of 1997 after Sallie Mae discontinued its loan consolidation program, but an increase in applications never materialized.

In the first six months of this year, EDS processed roughly 2,000 applications each week. EDS has expanded capacity and hired additional staff and now can handle a 50 percent increase in volume to 3,000 consolidations each week. By October 1, it could double volume to 4,000 consolidations each week.

8. **What contingency plans do you have in place should increased application volume begin to overwhelm EDS's capacity to process consolidation loans?**

As I described in my July 28 letter to Chairman Goodling, the Department is pursuing other means of obtaining additional capacity to process direct loan consolidations should the need arise. We are examining our options to obtain the services of organizations with closely related experience and a proven track record of performance, such as guaranty agencies and other financial institutions.

The Department is now in the process of defining its requirements for additional consolidators. We will state these requirements in terms of performance outcomes, rather than process steps, and will consult with interested organizations before initiating the formal procurement process. The Office of Management and Budget has recommended that agencies contact the industry early in the process to ensure that the requirements are comprehensive with clear performance expectations and will not unnecessarily restrict competition, increase costs, or stifle innovation.

9. **EDS was required to perform an evaluation of the 1,000 initial applications to determine whether problems with the loan consolidation process had been successfully resolved. Please provide me with the results of this evaluation.**

Price Waterhouse, the Independent Quality Control Unit (IQCU) for the direct loan consolidation contract, agreed to analyze EDS's performance in processing 1,000 applications that were among the first EDS received after December 1, 1997. Several weeks ago, we asked Price Waterhouse to compile its analysis on these applications into one report. I provided you with a copy of that report on August 10.

Price Waterhouse concluded that the evidence showed that "the loan consolidation process has been considerably improved when compared to cycle time processing, accuracy, and inventory levels reported before the reengineering effort took effect."

I hope that this information is useful to you. If I can be of any further assistance, please do not hesitate to let me know.

Sincerely,

Marshall S. Smith
Acting Deputy Secretary

Enclosure

UNITED STATES DEPARTMENT OF EDUCATION

THE DEPUTY SECRETARY

The Honorable William Goodling
Chairman
Committee on Education and the Workforce
U.S. House of Representatives
2181 Rayburn House Office Building
Washington, DC 20515-8100

AUG 21 1998

Dear Chairman Goodling:

In response to a request from your office, we have been assembling certain additional information concerning the Direct Consolidation Loan program. I am pleased to provide you today with that additional data. As you will see, these data are consistent with other reports we have provided to you and other Members of Congress regarding the smooth operation of the Direct Consolidation Loan program. The Department intends to make updated versions of the two enclosed tables available through our web site every two weeks.

Applications Received. The first table reflects the number of applications received during each biweekly period since December 1, 1997. As you know, the Department's biweekly reports to Congress have included only those applications that have been reviewed, determined to be complete, and therefore "accepted" by the Department's loan consolidation contractor, Electronic Data Systems, Inc. (EDS). These applications include all the information necessary for EDS to begin processing the application. Because EDS cannot process incomplete applications, we believe that this is the most accurate way to report this information.

The enclosed table describing received applications includes both complete applications received by EDS as well as applications that are not complete for various reasons (such as a missing lender name or borrower address). This table does not include applications that were reviewed in the EDS mailroom and immediately returned to the borrower because they were missing certain vital pieces of information, such as a social security number or a signature. Once these latter applications are revised and returned by the borrower, they are treated as received and dated based upon the date of receipt of the returned, revised application.

As noted above, received applications are not officially "accepted" until they are reviewed, determined to be complete, and entered into the EDS processing system. EDS has accepted over 95 percent of the applications it has received since December 1, 1997. (This figure excludes applications rejected by the EDS mailroom and not yet resubmitted by the borrower, since those applications will be dated once they are returned by the borrower.) EDS currently has about 2,400 applications -- a number equal to about three or four days of receipts -- that are in the standard process of moving from received to accepted applications. During this process, EDS examines each application, resolves any miscellaneous data issues, and enters the application into the EDS processing system. As for the remaining 800 applications that have not yet been accepted, EDS has requested missing information from the borrower and is waiting for their responses.

Applications Requested. I have also enclosed a table that describes for each biweekly period since December 1, 1997, the number of Direct Consolidation Loan applications that EDS has mailed in response to borrower requests for such applications.

Proportion of FFEL loans. Although EDS does not routinely track whether one or more of a borrower's underlying loans were obtained under the Federal Family Education Loan (FFEL) program, we asked EDS, in response to your request, to provide us with a breakdown of applications that included underlying FFEL loans and those that did not.

There has been no change since July 1 in the proportion of applicants applying for a Direct Consolidation Loan who have one or more FFEL loans held by the FFEL industry. For the period July 1 through August 14, 1998, roughly 74 percent of applicants have one or more FFEL loans held by the FFEL industry, while the remaining 26 percent of applicants had only FFEL loans held by the Department's Debt Collection Services or direct loans. These are the same proportions that applied for the period December 1, 1997, through June 30, 1998.

I hope this information is helpful to you.

Sincerely,

Marshall S. Smith
Acting Deputy Secretary

Enclosures

Direct Loan Consolidation Program Applications Received Since December 1, 1997	
Two-Week Period Ending	**Two-Week Total***
December 12, 1997	1,480
December 26, 1997	3,771
January 9, 1998	4,341
January 23, 1998	5,858
February 6, 1998	5,918
February 20, 1998	6,276
March 6, 1998	5,260
March 20, 1998	4,735
April 3, 1998	4,542
April 17, 1998	4,161
May 1, 1998	4,413
May 14, 1998	3,706
May 29, 1998	4,606
June 12, 1998	4,411
June 26, 1998	4,640
July 10, 1998	4,612
July 24, 1998	5,628
August 7, 1998	6,653

* This figure does not include applications that were returned to the borrower because, for example, they were not signed or did not include a social security number. Such applications are dated as received when the borrowers complete and return them.

U.S. Department of Education
August 18, 1998

Direct Loan Consolidation Program
Applications Mailed in Response to Borrower Requests*
Since December 1, 1998

Two-Week Period Ending	Two-Week Total
December 12, 1997	9,320
December 26, 1997	10,011
January 9, 1998	11,056
January 23, 1998	18,526
February 6, 1998	10,991
February 20, 1998	7,571
March 6, 1998	7,568
March 20, 1998	11,654
April 3, 1998	9,286
April 17, 1998	8,080
May 1, 1998	10,916
May 15, 1998	9,490
May 29, 1998	8,124
June 12, 1998	9,599
June 26, 1998	10,067
July 10, 1998	13,400
July 24, 1998	16,950
August 7, 1998	14,145

* This table indicates the number of paper application forms mailed to borrowers by EDS, the method of application for Direct Consolidation Loans chosen by most borrowers. Borrowers may also apply through other means, such as by downloading an application from the Department's web site. Prior defaulters may also apply through the Department's Debt Collection Services.

U.S. Department of Education
August 20, 1998

Attendance

Access America Briefing

Name	Association
Bob Shireman	White House NEC
Terry Hartle	ACE
JERRY ROSCHWALB	NASULGC
Marty Guthrie	NASFAA
BARMAK NASSIRIAN	AASCU
HILARY GOLDMANN	AASCU
Howard E. Holcomb	CIC
Christine Larger	NACUBO
Diane Hampton	ACE
NOAH BROWN	ACCT
Stephanie Giesecke	ACCT
Susan Smoter	NPR
Kathy Stack	OMB
Roxie LaFever	KPMG
Ivan Frishberg	U.S.PIRG
PAUL MASSEY	ACE
CHRIS SIMMONS	AAU
Cyndy Littlefield	AJCU
Maureen Budetti	naicu
Debbie Brown	ED
GINA PEARSON	NPR
Becky Timmons	ACE
[illegible]	ED
[illegible] Woods	NPR

Access America 7/29/98

- Jesuit Colleges
- USSA?
- Ivan F.

Q. Rollout in Aug? Need sign-offs from: (1) FMS for consolidated accts.
+ Maybe delay
(2) security transactions. Winding next week.

Q. Partners: IHEs + banks (card issuers & processors)

Q. Task Force: Feds + Contractors
Steering Group of Agency Heads - monthly
Council for coordinating

Tomall: Rollout fine, but leave Kid's out...
Vision is breathtaking, exciting ... the [illegible] is right on [illegible]..
Kid's will drag the whole thing down,
the age
Community is in full retreat from EASI vision because too expansive, and
this is more expansive.
- I'll help you get schools...
But system Δ - not likely @ E.D. and at [illegible]....

A. Karlyn + Greg
Cautious well-taken
Test the waters — with eyes open...

A: Roxy Lefever - KPMG Peat Marwick

Mark Brown: Tax Credits
- CC Trustees,

A. Bob Baur @ IRS - will take it up w/ him.

Reality

· Doug Dds TESCR → RARSA Y questions ??

- Mental training

Susan Smiter - Prog. Director
- ea (call from postal service
- ldg.-edge tech proposals
- worldwide sec. delivery...
- new business don't using emergency
challenges...

Greg Woods -
. NPR - VP since beginning - Spring '93
corp. CEO in IT industry - 2 decades
- start up co's...

. Chair emergency comm. esp. by dis. &
comm - access & record

- Mark Rogers
- Delphine Brown

Access America for Students

Higher Education Association

Briefing

July 30, 1998

Agency Electronic Student Services

Migration Requirements

Agency	Current Services ➡	Desired Services	⬅ Tools Needed
Education	♦ FAFSA ♦ NSLDS on the web (planned pilot)	♦ Single Student Account ♦ Electronic Origination and Payment ♦ Electronic Signature for FAFSA/Loan Applications	♦ Electronic ID ♦ Electronic Address Changes ♦ Student Account Structure
Internal Revenue	♦ Tele-filing of 1040EZ forms (25 million mailed only 6 million returned)	♦ Tele-file or electronic filing of all student 1040EZ tax returns	♦ Electronic ID ♦ Secured Web Payments ♦ Electronic Address Changes
Veterans Affairs	♦ School Eligibility Certifications (3,000 schools)	♦ Initial Benefit Eligibility Application ♦ Veteran Monthly Enrollment Certifications	♦ Electronic ID ♦ Electronic Address Changes
Postal Services	♦ Access to Address Change Form on Web (requires mailing notifications to old and new addresses prior to change)	♦ Receive address changes via website (automatic change by effective date) ♦ Post Office On-Line	♦ Electronic ID ♦ Secured Web Payments ♦ Electronic Address Changes
National Recreation	♦ Park Campsite Reservations	♦ Coordinated service through student sites	♦ Website Links ♦ Secured Web Payments

DETERMINED TO BE AN
ADMINISTRATIVE MARKING
INITIALS: JAM DATE: 10/19/17
2017-1069-F

Phase I

A Core Suite of Services for Students

Participating Student

Electronic Access

Agencies/Schools with On-Line Transactions

Department of Education	• FAFSA • ACCOUNT INFORMATION
UNITED STATES POSTAL SERVICE	• ADDRESS CHANGE • ZIP LOOK-UP • POSTAGE CALCULATOR
National Park Reservation Service	• PARK RESERVATIONS
IRS	• E-FILE SERVICES
Veterans Affairs	• MONTHLY ENROLLMENT CERTIFICATION
College & University	• REGISTRATION • GRADES • TUITION PAYMENT • ADMISSION

Eligible students will be able to access additional benefits and services as they are brought on-line.

Electronic ID Approval Process

Prior Participants

Requests Electronic ID →

Access America for Students Website

Basic Identification Information (such as Name, Address, DOB)

Prior Participant:
- ✓ Student Financial Aid
- ✓ E-filed Tax Return
- ✓ Veterans Benefits

Trusted Third Party **

Validates Data Against Federal Agency Active Participants

Mails Electronic ID to Student

Validates Electronic ID at Transaction Level for Participating Agencies

** Pilot - Federal Card Contract, Long-term - ACES

New Participants*

Registration Agent* *(Face-to-Face)*
- Schools
- Banks
- Postal Service
- DMV

Dept. of ED Financial Aid Recipient Database

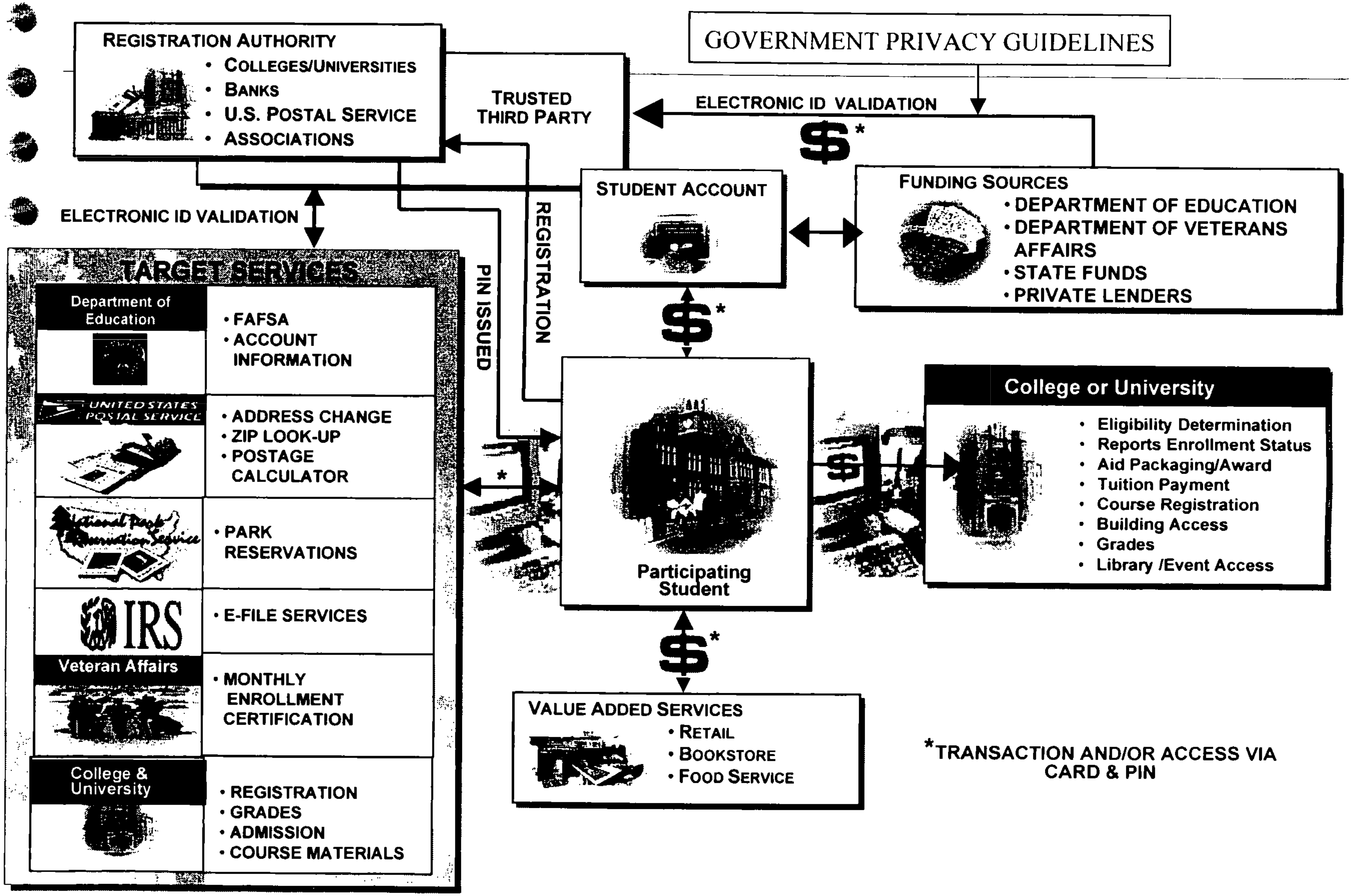
Internal Revenue E-file Tax Filer Database

Postal Service Active Address Database

Veterans Benefits Veteran Monthly Certification

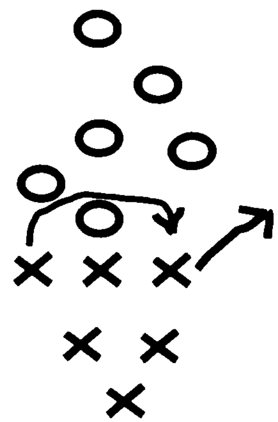
* Face-to-face required when no database matches from prior federal participants.

Phase II
Enhanced Services - The Student Account

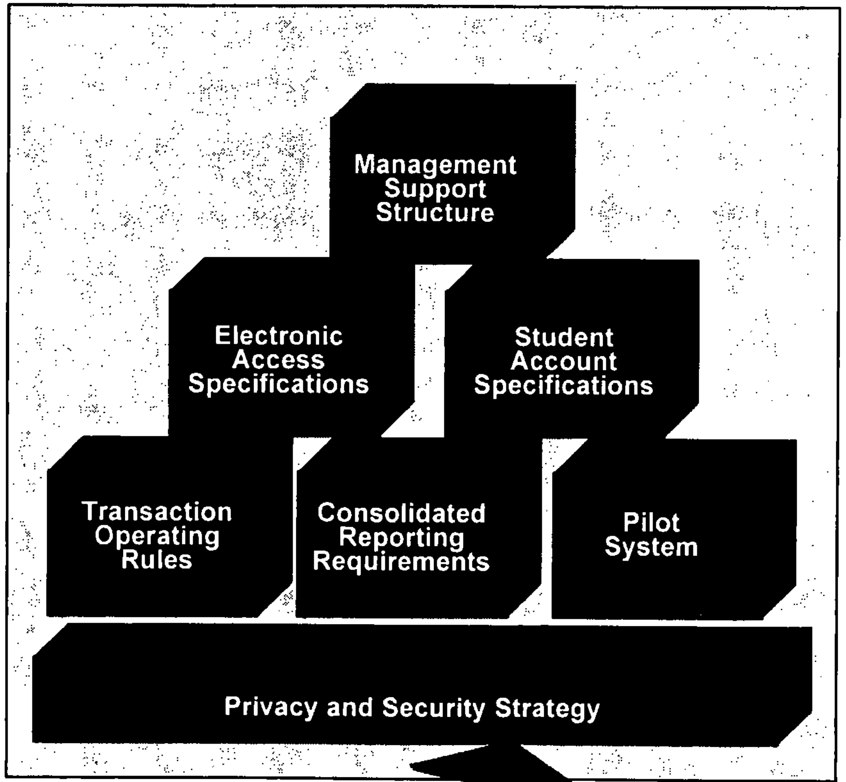


Access America for Students Game Plan

- ✓ Access America Workshop - May 1998
- National Announcement - August 1998
- Agreements with Partners
- Create Task Force
- 5 School Pilot
  - Fall 1998 - Core Services w/Electronic ID
  - Spring 1999 - Student Account
- 50 School Demonstration - Fall 1999
- National Availability - Fall 2000



Getting the Job Done



Access America for Students Task Force

- **Steering Committee**
  - Agency Heads
  - OMB and NPR
- **Public/Private Partnership Council**
- **Full-Time Staff**
  - Project Director
  - Agency Representatives
  - Support Contractors
- **Next Steps**
  - Program Announcement
  - Stakeholder Outreach Network
  - Sign Up Partners
  - Building Blocks

6/3/98

Abramcheck & S. Ward

- ED: Sterling Yoder @ ED (former Chase)

- Refinancing – in scope

Can do 4-4500/week

- 2 weeks training on front-end
- 6 weeks for customer svc. rep.

- When does rate lock in??

- Automatically lower the rate for D.C.
  DON'T RECONSOLIDATE.. just lower it...

- Parallel p-note – do sooner? combined app/p-note. (FFEL does it)
  ED has the white paper (Sterling)

Frank Abramcheck, Ph.D.
Program Manager
Department of Education

Government Services Division
4200 Wilson Boulevard, Suite 400
Arlington, Virginia 22203
(703) 741-7476 Fax: (703) 741-7494
Internet: frank.abramcheck@eds.com

EDS

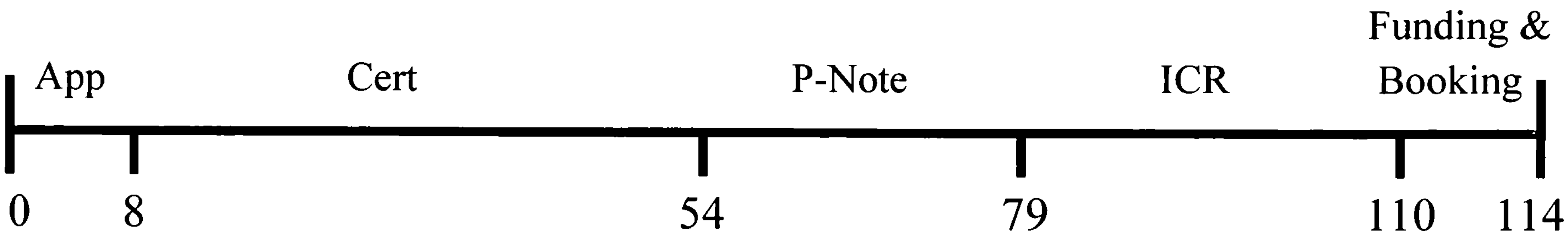
Direct Loan Consolidation Status Review

June 3, 1998

EDS

Consolidation Process

"Standard" Processing Times (*in days)*



Application
Complete Data
Correct Information

P-Note
Correct Amount
Prompt Return

Certification
Correct Lender
Valid Payoff Amount
Timely Turnaround

ICR
Timely Returns from Borrower
Timely Turnaround

EDS

Initial Start-Up and Transition

- September 16, 1996
- Backlog of Applications from Former Processor
- Poor Quality of Application Data
- Exception Processing Limitations
- Certification and Lender Issues

EDS

Shutdown / Process Redesign

- Revamp Workflow
- Focus on Clean Data
- Clear Communication with Borrower
- Identification of Correct Loanholder
- ReInitiate Processing on December 1, 1997

EDS

Backlog Resolution

August 1997

- Suspend Receipt of New Applications
- Number of Applications Received - 142,856
- Number of Applications in Backlog - 84,078

December 1997

- Number of Applications in Backlog - 1,774

EDS

Post Funding Activities

Borrower Action Team

- Issues Resulting From Incorrect Payoff or Posting
- Action Plan Completion Date - August 1998
- Inventory of Pending Transactions

  Posting to Servicer from CDS - 3,348

  Correction to Servicer from CDS - 737

  Internal Funding - 1,730

EDS

Overall Statistics

"Old System" Applications - Prior to December 1997

- Receipts - 142,856
- Booked - 101,649 — 5,500 [illegible] : gotten is [illegible] (see previous page)
- Deactivated - 37,592
- Pending a Supplemental - 3,615

EDS

Overall Statistics

"New System" Applications - Post December 1997

Total Applications Received in Mailroom	60,123
Rejected/Incomplete Applications	2,722
Total Accepted Applications	57,401
Fully Booked	33,619
Deactivated	7,830
Pending Applications	15,952
Certifications	6,603
P-Note Review	3,505
P-Note	3,759
P-Note Returned, Awaiting ICR	1,287
Pending with Deactivations or Supplementals	798

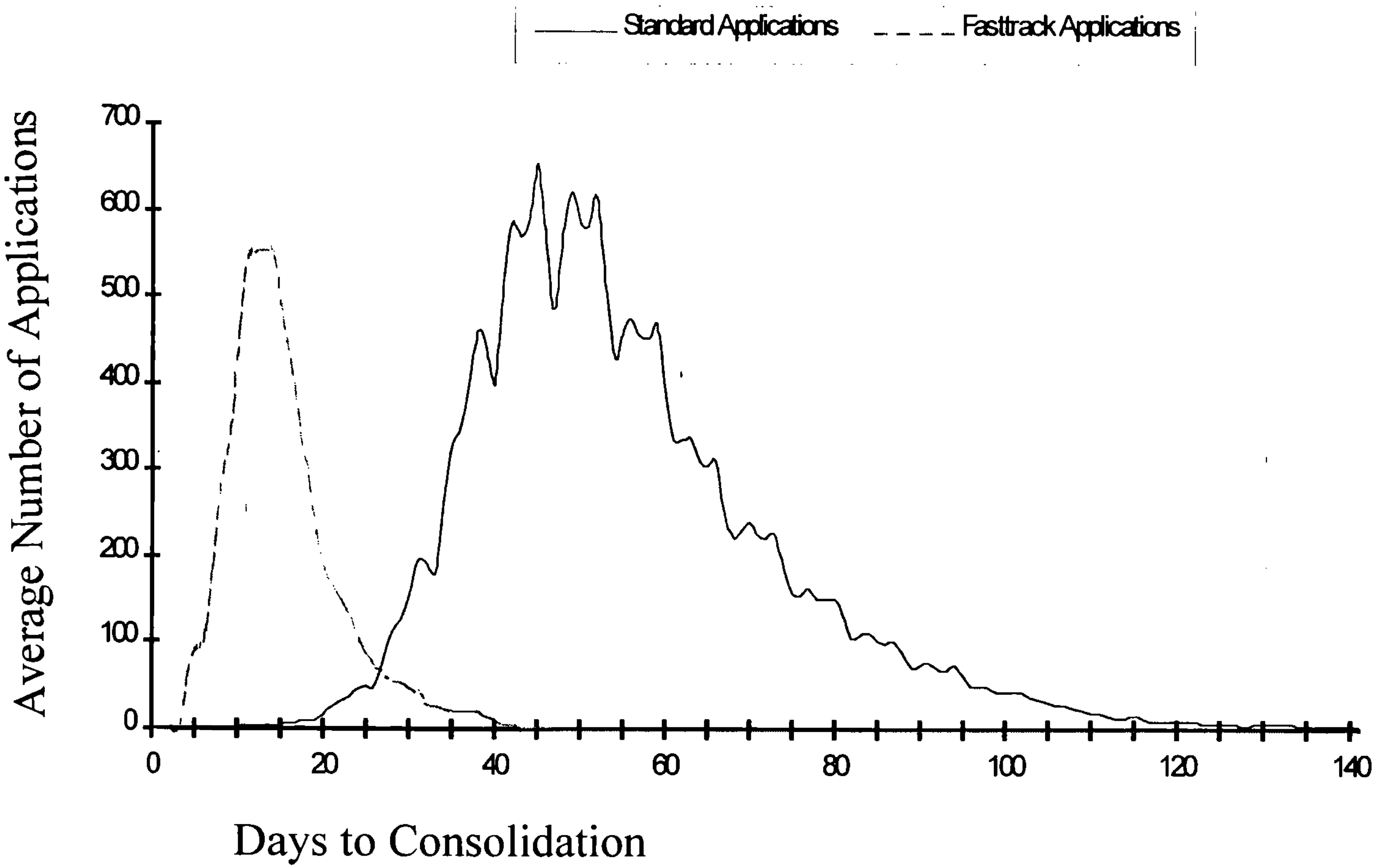
- fewer than half of requests for app (140,000) - % waiting for [illegible].

- Largest: must do ICR, but haven't signed

EDS

Average Days for Consolidation of Applications

December 1997- May 1998



EDS

“New System” Application Status

Standard

as of June 1, 1998

Date Received	Applications Accepted by Period	Applications with First Time Bookings		Applications Deactivated Withdrawn or Purged	Total Applications Pending		Applications in Certification		Applications in PNote Review		Applications Awaiting Signed PNote		Applications PNote Returned Awaiting ICR		Exceptions	
	#	#	#Days to Completion	#	#	#Days in Status	#	#Days in Status	#	#Days in Status	#	#Days in Status	#	#Days in Status	# Pending w/ Deactivations	# Supplementals
December	3836	3175	64	645	0	0	0	0	0	0	0	0	0	0	16	0
January	10982	8708	53	2186	0	0	0	0	0	0	0	0	0	0	88	0
February	9820	7011	54	2037	464	90	43	72	33	45	107	23	281	46	288	20
March	9320	5091	48	2113	1827	61	264	56	175	29	707	13	681	23	260	29
April	8051	1370	39	770	5815	36	1091	32	2240	16	2170	10	314	12	52	44
May	6720	12	20	56	6651	13	5001	10	1004	7	641	8	5	3	1	0
TOTALS	**48729**	**25367**	**53**	**7807**	**14757**	**30**	**6399**	**16**	**3452**	**14**	**3625**	**11**	**1281**	**25**	**705**	**93**

Fast Track

Date Received	Applications Accepted by Period	Applications with First Time Bookings		Applications Deactivated Withdrawn or Purged	Total Applications Pending		Applications in Certification		Applications in PNote Review		Applications Awaiting Signed PNote		Applications PNote Returned Awaiting ICR		Exceptions	
	#	#	#Days to Completion	#	#	#Days in Status	#	#Days in Status	#	#Days in Status	#	#Days in Status	#	#Days in Status	# Pending w/ Deactivations	# Supplementals
December	2058	2046	19	12	0	0	0	0	0	0	0	0	0	0	0	0
January	1727	1724	10	3	0	0	0	0	0	0	0	0	0	0	0	0
February	1630	1626	12	4	0	0	0	0	0	0	0	0	0	0	0	0
March	1663	1657	12	2	4	0	4	0	0	0	0	0	0	0	0	0
April	773	765	12	2	6	0	6	0	0	0	0	0	0	0	0	0
May	821	434	12	0	387	3	194	0	53	4	134	4	6	12	0	0
TOTALS	**8672**	**8252**	**13**	**23**	**397**	**3**	**204**	**0**	**53**	**4**	**134**	**4**	**6**	**12**	**0**	**0**

UNITED STATES DEPARTMENT OF EDUCATION

THE DEPUTY SECRETARY

July 28, 1998

The Honorable William Goodling
Chairman
Committee on Education and the Workforce
U.S. House of Representatives
2181 Rayburn House Office Building
Washington, DC 20515-8100

Dear Chairman Goodling:

Thank you for your July 22, 1998, letter to Secretary Riley regarding the interest rate on consolidation loans made through the Direct Loan program on or after July 1, 1998. I am sending you this initial response on Secretary Riley's behalf. A similar response is being sent to the other signatories. We will provide you with the remaining information not later than Wednesday, August 5, 1998.

Before I answer your numbered requests for information, I would like to address several points you raise in your introductory remarks. First, I appreciate your support for both the Direct Loan and the Federal Family Education Loan (FFEL) programs. President Clinton, Secretary Riley, and I agree with you that the best interests of students, their families, and taxpayers are served by continuing two strong loan programs and leveling the playing field between them to the extent feasible. I look forward to continuing to work with you toward this goal.

The Administration took a step in this direction by including in our proposal for the reauthorization of the Higher Education Act (HEA) a reduction in the interest rate on FFEL consolidation loans that is the same as that being offered on Direct and FFEL student loans, as well as Direct Consolidation Loans. We urge that the final HEA legislation ensure that consolidation loan borrowers in both programs receive the same low interest rate and that lenders receive a fair return on these loans.

Second, I regret that you apparently regard the reduced interest rate on Direct Consolidation Loans as a "unilateral decision" made by the Department. As you know, the Transportation Equity Act for the 21st Century, which became law in June, provided lower interest rates for new student loans effective July 1. Consistent with the Department's longstanding regulations and policy, the interest rate on Direct Consolidation Loans was also reduced to match the interest rate on new Direct Student Loans. In advance of this action, I sent a letter (on June 19) to the authorizing committee leadership, and Administration officials also met with Subcommittee Chairman McKeon, Ranking Member Kildee and a number of committee staff from both parties to share the Department's plans.

The Department's regulations have consistently provided that the interest rate on Direct Consolidation Loans be the same as the interest rate on new Direct Student Loans made at the same time as the consolidation loans. This rule has been in place since the Department first issued rules governing the Direct Consolidation Loan program in July 1994 and is consistent with the Higher Education Act (HEA).

The reduction in the interest rate also corresponds with the Administration's broader policy of helping families pay for college. The 0.8 percentage point reduction in interest rates is strongly supported by student groups and the higher education community because it will significantly benefit borrowers struggling to repay their loans. For example, the average consolidation loan borrower with a debt of $19,000 will save close to $1,000 over the standard ten-year repayment period.

Third, you raise questions regarding whether the Direct Consolidation Loan program has overcome the problems that hampered it last fall. In the last year, the Department has worked with our loan consolidation contractor, Electronic Data Systems, Inc. (EDS), to redesign and strengthen the direct loan consolidation process. The most important improvements to the consolidation process include:

•**Improving processing speed and accuracy** by re-engineering the process by which the loan holder certifies loan balances and by encouraging electronic data transfer;

•**Improving data accuracy** by obtaining better information early in the process, enhancing data entry procedures, and using the National Student Loan Data System to verify loan information earlier in the application process;

•**Adding contractual, performance-based incentives** to improve performance;

•**Creating new managerial controls and monitoring mechanisms** such as improved tracking of applicant information, new management reports, and quality control measures; and

•**Increasing contractor staff to assure high quality customer service,** including hiring additional systems engineers and consultants with prior student loan industry experience last fall and substantially increasing staff this summer to prepare for a possible increase in demand for consolidation loans.

•**Increasing and reorganizing Department staff** responsible for overseeing the Direct Consolidation Loan program.

As a result, we have materially strengthened the Direct Consolidation Loan program and EDS has been smoothly processing new applications this year. EDS has also substantially improved average processing times, from over 140 days one year ago to well within the industry standard of 60 to 90 days today.

Fourth, I have several comments on your discussion of various statistics regarding EDS's performance. Citing statistics from one of the Department's recent reports to Congress, you state that "the Department's completion rate" for applications received between December 1, 1997, and June 12, 1998, is approximately 58 percent. However, this statistic is misleading because it includes applications that are still within the normal processing time.

For a more accurate indication of EDS's performance, I asked staff to examine EDS's performance on applications that it accepted more than 60 to 90 days ago. Between December 1, 1997, and April 30, 1998, EDS accepted roughly 49,900 applications. As of July 17, 1998, fewer than five percent of these 49,900 loan applications remain to be completed by EDS, and nearly half of these applications have been delayed while waiting for applicants to provide necessary information. All of the rest have either been booked or deactivated because the borrower changed his or her mind.

Finally, your letter says that "the Department is apparently not counting all applications received." I presume that you are referring to those applications that are not accepted because they are incomplete. For example, in order for EDS to process an application, it must include a valid social security number and a signature. As noted on the Department's bi-weekly reports to Congress, these reports include only valid applications. Since EDS cannot process incomplete applications, we believe that this is the most accurate way to report this information.

When EDS receives an incomplete application, it contacts the applicant and solicits the missing information.

Answers to your specific requests for information follow.

1. A list of all direct or indirect public relations efforts to advertise the Department's new direct consolidation loan interest rates, including all press contacts and public pronouncements by Department officials and employees, all public service announcements, as well as any mailings or electronic notifications to financial aid administrators or borrowers. In each instance, please note whether similar efforts were made by the Department to publicize the reduction in FFEL Consolidation Loan rates enacted with the passage of the Emergency Student Loan Consolidation Act of 1997.

We did not issue a news release or proactively seek any media coverage regarding the new interest rate on Direct Consolidation Loans, although some other members of the student lending community chose to mention the lower rates in their own news releases. We did respond in a timely manner to provide accurate information to all incoming press inquiries, as we do with inquiries on all subjects on a daily basis.

Records maintained by the Office of Public Affairs indicate that they provided information -- including written fact sheets and interviews with Department staff -- to the following news agencies upon request: the Associated Press, the Philadelphia Inquirer, the Chronicle of Higher Education, Smart Money, Education Daily, Education Week, Money Magazine, the Washington Post editorial board, Marketplace Radio, Student Lending Update, Time Magazine, MTV, and Roll Call.

Following our standard procedures, the Department also took steps to ensure that our customers receive timely and accurate information. The Department distributed three fact sheets to its customer service representatives who interact with borrowers and financial aid professionals, including employees of the direct loan contractors and the Public Information Contractor (which operates the toll-free number, 1-800-4-FED-AID). We posted these materials to our web site as well as the electronic distribution lists for financial aid professionals that you mention. These materials were provided to your staff on July 2, the same day they were distributed to our contractors. We also posted the federal register notice to our web site, consistent with our standard procedure.

In addition, Department officials briefly mentioned the reduced interest rates to the National Association of Student Financial Aid Administrators and the Higher Education Association of the Rockies in remarks on recent changes in the student aid programs.

Through both our contacts with the media and our public fact sheets, we simply tried to respond to inquiries and provide factual information regarding the interest rates in each program without advocating or recommending either program.

In response to the latter part of your question regarding the new interest rate on FFEL consolidation loans enacted in the Emergency Student Loan Consolidation Act of 1997, the Department noted the FFEL interest rate change in its November 13 news release on the passage of the fiscal year 1998 appropriations bill for the Department of Education. In addition, Department officials provided information to at least the following publications on the Emergency Student Loan Consolidation Act and related issues: the American Banker, the Associated Press, Bloomberg Business News, the Chronicle of Higher Education, Education Daily, and Student Lending Update.

The Department also took steps to ensure that borrowers and financial aid professionals had access to reliable information following the passage of the Emergency Student Loan Consolidation Act. We promptly met with the FFEL community and took action to ensure that our customer service representatives were aware of the new interest rate on FFEL consolidation loans. In addition, we prepared a Dear Colleague letter regarding the new interest rate and procedures that FFEL lenders should follow to consolidate direct loans. The Department made this letter available both electronically via its web site and in paper form by mailing it to a list of 17,000 financial aid professionals.

2. A report of the complaints made against the Department or its servicer since December 1, 1997, related to a consolidation loan application or completed consolidation loan. Please indicate the number of complaints and the general nature of complaints (e.g., incorrect payoff of FFEL loans, delay in payoff of outstanding loans, incorrect balance amount on statements to borrowers, or no statements to borrowers).

We are in the process of conducting a search of our records and those of our contractors, and we will provide this information to you by August 5.

3. Any increase in direct loan consolidation applications experienced to date and the volume of applications expected over the next 12 months.

I have enclosed a table which lists the number of Direct Consolidation Loan applications accepted by EDS each week since December 1, 1997. As you can see, there has been somewhat of an increase in these applications since July 1. Although there may be a further increase in application volume in the future, changes in volume are difficult to predict. Past projected increases in volume have not always materialized. For example, the Department expected an increase in loan consolidation volume in the Fall of 1997 after Sallie Mae discontinued its loan consolidation program, but an increase in applications never materialized.

4. The number of direct loan consolidations expected to be completed by the Department and its contractor for each month starting with July.

The Department's Direct Consolidation Loan contractor, EDS, is now consolidating about 2,000 applications each week. EDS is capable of completing 3,000 consolidations each week, 50 percent more than its current volume. By October 1, EDS could be capable of completing 4,000 consolidations each week, twice as many as it is currently processing.

The Department is also pursuing other means of obtaining additional capacity to process direct loan consolidations, should the need arise. We are examining our options to obtain the services of organizations with closely-related experience and a proven track record of performance, including guaranty agencies and other financial institutions.

5. A report detailing any steps the Department has taken to ensure the readiness of EDS to increase the volume of consolidation loans processed in either its Montgomery, Alabama facility or its Louisville, Kentucky facility.

We have attached great importance at the most senior levels of the Department to preparing for a possible increase in volume. I hold regular meetings on this subject in my office several times each week. I have also communicated my expectations to senior EDS management in meetings and telephone conversations.

In anticipation of a possible increase in volume, the Department and EDS have:

•**Expanded EDS's processing capacity.** This summer, EDS has hired additional staff to enable it to process 3,000 consolidations each week, up from about 2,000.

•**Developed special procedures** to track closely demand for Direct Consolidation Loans and EDS's performance in meeting that demand.

•**Increased monitoring of key indicators** to detect and respond to increases in demand.

•**Established a process to control the flow of "fast track" consolidation applications** from the Department's Debt Collection Services on defaulted loans, if necessary.

•**Trained additional Department staff in direct loan customer service** so that they will be ready to respond to borrower inquiries and help address any difficulties in obtaining a Direct Consolidation Loan, if necessary.

•**Enabled borrowers to download an application** for a Direct Consolidation Loan from the Department's web site and are developing an interactive loan consolidation application on the Web.

You also mention an April report from the General Accounting Office (GAO) titled "Direct Student Loans: Efforts to Resolve Lenders' Problems with Consolidations Are Under Way." As you mention, the authors of this report concede that their research was conducted too early to assess the effectiveness of the Department's efforts to improve this program. The report concludes that "the changes that Education and EDS are putting into place appear to move in the right direction."

Answers to your specific requests for information follow.

1. The results of the EDS evaluation of the 1,000 initial applications, which was due in mid-January.

Price Waterhouse, the Independent Quality Control Unit (IQCU) for the direct loan consolidation contract, agreed to analyze EDS's performance in processing 1,000 applications that were among the first EDS received after December 1, 1997.

Price Waterhouse began making reports to the Department in January 1998. However, Price Waterhouse was never expected to complete its analysis in that period, which is much shorter than the typical loan consolidation process.

We have asked Price Waterhouse to compile its analysis on these applications into one report, which we will provide by August 5.

2. A report detailing the steps taken by the Department and its contractor to remedy the problems identified by the GAO and a detailed evaluation of the effectiveness of those remedies.

We will provide this information to you by August 5.

3. Aging statistics of all direct consolidation applications currently being processed.

I have enclosed a table which contains this information. As you can see, EDS is processing applications well within the industry standard of 60 to 90 days.

4. A report detailing whether all of the necessary direct consolidation loan accounts are being properly reconciled.

We will provide this information to you by August 5.

I hope that this letter has begun to answer your questions and I look forward to providing the remaining information you requested.

Sincerely,

Marshall S. Smith

Marshall S. Smith
Acting Deputy Secretary

Enclosures

Applications for Direct Consolidation Loans
By Week

Week Ending	Applications Accepted
December 5, 1997	38
December 12, 1997	865
December 19, 1997	761
December 26, 1997	1,802
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January 9, 1998	2,748
January 16, 1998	3,394
January 23, 1998	2,405
January 30, 1998	2,825
February 6, 1998	2,003
February 13, 1998	2,590
February 20, 1998	3,916
February 27, 1998	3,598
March 6, 1998	2,982
March 13, 1998	2,261
March 20, 1998	2,105
March 27, 1998	2,269
April 3, 1998	2,181
April 10, 1998	2,236
April 17, 1998	1,848
April 24, 1998	2,229
May 1, 1998	2,327
May 8, 1998	2,027
May 15, 1998	2,087
May 22, 1998	134*
May 29, 1998	3,785
June 5, 1998	2,177
June 12, 1998	2,099
June 19, 1998	1,959
June 26, 1998	1,907
July 3, 1998	1,938
July 10, 1998	2,867
July 17, 1998	2,720
July 24, 1998	2,849
TOTAL	**75,917**

*Due to a computer system upgrade, data for most of this week were reported as part of the following week's statistics.

Office of Student Financial Assistance
July 28, 1998

Status of Direct Consolidation Loan Applications By Month of Receipt[1]

Between December 1, 1997 and July 24, 1998

	Dec.	Jan.	Feb.	Mar.	Apr.	May	June	July	TOTAL
Applications Accepted[2]	5,895	12,715	11,453	10,992	8,848	8,492	10,228	7,294	75,917
In Process[3]	28	150	341	710	1,223	1,959	6,720	6,646	17,777
•**Step 1:** Obtaining lender certification.	4	12	34	71	119	226	2,135	5,792	8,393
•**Step 2:** In underwriting process.	1	8	5	7	19	85	834	251	1,210
•**Step 3.** Obtaining signed promisory note from borrower.	2	16	31	97	234	691	3,148	572	4,791
•**Step 4.** In ICR process.[4]	21	114	271	535	851	957	603	31	3,383
Deactivated or Withdrawn[5]	588	1,836	1,939	1,809	1,283	1,207	755	21	9,438
Completed (Consolidated or Fully Booked)	5,279	10,729	9,173	8,473	6,342	5,326	27,53	627	48,702

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[1]Each column represents the cohort of applications received during that month. For example, in December, 5,895 applications were received. As of July 24, 5,279 of the December applications have been consolidated (fully booked); 588 have been deactivated or withdrawn; and 28 are in process, which includes applications that were deactivated and later reactivated by the borrower and applications for which the loans have been consolidated (first booked) but the borrower requested within 180 days of the first booking that an additional loan be added to the consolidation loan.

[2]These figures include only applications that have been reviewed and accepted as complete. Every accepted application is either "in process," "deactivated or withdrawn," or "completed."

[3]The "in process" row is the total of all applications in steps one through four. This category includes applications that were deactivated and later reactivated by the borrower, applications for which the loans have been consolidated (first booked) but the borrower requested within 180 days of the first booking that an additional ('supplemental') loan be added to the consolidation loan, and applications that are simply still in process. For example, for the months of December, January and February, 508 of the 519 applications "in process" are either reactivations or supplementals, and all the rest are in the extra step for income contingent repayment.

[4]These applications are for borrowers who have selected or have been assigned the Income Contingent Repayment (ICR) option and are awaiting the approval of the waiver from the IRS or receipt of alternative documentation from the borrower.

[5]An accepted application can be deactivated at any stage in the process if a borrower who has provided incomplete information fails to respond within 21 days to a request for additional information. The application can be reactivated when the borrower provides the requested information.

Office of Student Financial Assistance
July 28, 1998

June 10, 1998

Director of Financial Aid
Iowa State Univ Of Science & Tech
214 Alumni Hall
Ames, IA 50011

Dear Director of Financial Aid,

Remember the program brochure you received in the mail a couple of weeks ago? Well, we have more information to share with you that saves your students even **more money**!

The President is expected to sign into law a Temporary Student Loan Provision that was passed by congress as part of the Intermodal Surface Transportation Efficiency Act (ISTEA). This bill sets the interest rates on student loans at the 91 day Treasury Bill plus 1.7% during the in school period and the 91 day Treasury Bill plus 2.3% during repayment.

In addition to these substantial savings, T.H.E., through our funding mechanism, is able to provide the following benefits to your students:

> ***We will pay 1% of the origination fee on subsidized Stafford loans***

> ***We will pay the 1% guarantee fees on subsidized and unsubsidized Stafford loans***

> ***We will pay the 1% guarantee fee on all PLUS loans***

A second year student borrowing $3,500 in subsidized Stafford loans would get an extra $70.00 in loan proceeds. A fourth year student borrowing $5,500 in subsidized Stafford loans would get an extra $110.00 in loan proceeds. These savings are right up front, when your students need it most - to help pay their tuition. In addition, your students receive the T.H.E. Bonus too!

Enclosed are a few application kits for you to review. To order more, simply call us or complete the order form included within this mailing.

There was uncertainty in the student loan market with the pending interest rate situation. Now that we know the rates after July 1, here are our terms. Are other programs willing to match our post July 1 savings?

Call us at 1-800-366-0004 with questions.

Sincerely,

T.H.E. Loan Program

TOTAL HIGHER EDUCATION T·H·E

Serving Your Students MORE...

Attachments

With T.H.E.

Total Higher Education T.H.E.
offers your students substantial savings!

The President is expected to sign into law a Temporary Student Loan Provision that was passed by Congress as part of the Intermodal Surface Transportation Efficiency Act (ISTEA). This bill sets the interest rates on Federal subsidized and unsubsizidized Stafford loans as follows:

While in-school, grace and authorized periods of deferment	**91 Day Treasury Bill plus 1.70%**
During repayment	**91 Day Treasury Bill plus 2.30%**

The interest rate ceiling on these loans remains at 8.25%

T.H.E. Federal Loan Facts

	Stafford Loan Terms Loans Disbursed on 7/1/98 and before 10/1/98	PLUS Loan Terms Loans Disbursed on 7/1/98 and before 10/1/98
Guarantee Fee	**0%**	**0%**
Origination Fee	*subsidized / unsubsidized* **2%** 3%	3%
Interest Rate In-School At Repayment	**91 Day T-Bill + 1.7%** **91 Day T-Bill + 2.3%**	**91 Day T-Bill + 3.1%** **91 Day T-Bill + 3.1%**

Students can borrow less and save more!!!

Here's an example of how your students can save with T.H.E.'s Loan Program

Amount Borrowed	Subsidized Stafford Loan Amount	Guarantee Fee Student Will Pay	Origination Fee Student Will Pay	Disbursement Funds Received	More Money for Your Students
Through T.H.E.					**Total Savings**
Freshmen	$2,625.00	$0.00	$52.50	$2,572.50	$52.50
Sophomore	$3,500.00	$0.00	$70.00	$3,430.00	$70.00
Junior or Senior	$5,500.00	$0.00	$110.00	$5,390.00	$110.00
Graduate	$8,500.00	$0.00	$170.00	$8,330.00	$170.00
Lender A					
Freshmen	$2,625.00	$26.25	$78.75	$2,520.00	$0.00
Sophomore	$3,500.00	$35.00	$105.00	$3,360.00	$0.00
Junior or Senior	$5,500.00	$55.00	$165.00	$5,280.00	$0.00
Graduate	$8,500.00	$85.00	$255.00	$8,160.00	$0.00

The above terms are applicable for loans with a first disbursement on or before 9/30/98. The ISTEA has been authorized through 9/30/98, at which time the Temporary Student Loan Provision will be reviewed and a determination made. T.H.E. will continue to monitor this piece of legislation and update schools with any news as it becomes available.

Call 1-800-366-0604 for Questions

Order Form for applications on the back side **OVER**

ONCE THE PRESIDENT SIGNS THE ISTEA

T.H.E. will supply you with the tools necessary to communicate the applicable terms to the students

ORDER FORM

APPLICATIONS

☐ **STANDARD NATIONAL APPLICATION KIT**
(contains T.H.E. Federal and Alternative Applications)
QUANTITY __________
(50 applications per box)

☐ **FEDERAL LOAN CONSOLIDATION APPLICATION KIT**
QUANTITY __________
(please write in exact amount desired

SHIPPING INFORMATION (COMPLETE STREET ADDRESS REQUIRED)

School Name: __________

Deliver to: __________

School Code: __________

Attention: __________

Telephone Number: __________

PREFERRED DELIVERY METHOD:
☐ Standard (5-7 day deliver) ☐ Rush (2-3 day delivery) ☐ Overnight

CALL T.H.E. EXPERTS AT 1-800-366-0604
OR
FAX YOUR ORDER TO US AT 1-888-843-3098

www.northstar.org

FAX TRANSMISSION

U.S. DEPARTMENT OF EDUCATION
Office of Legislation and Congressional Affairs
600 Independence Ave., SW, Room 6337
Washington, DC 20202-3100
(202)401-1028
Fax: (202)401-1438

Date: 7/30/98 Fax: 456-2223

To: Bob Shireman

Office of :

From: Shelley Amdur

Number of Pages (including cover sheet):

If there are any problems with this transmission, please contact me at: (202)401-0020

Comments:

GUARANTORS

GUARANTEE AGENCY	ST	YEAR	TOP	FIVE	SALARIES			TOTAL
			1	2	3	4	5	
Stdn Loan Guar Found - AR	AR	9/30/97	$86,241	$67,511	$52,917			$206,669
CT Student Loan Fund	CT	6/30/97	$111,384	$76,085	$71,257	$60,185	$58,731	$377,642
USA Funds, Inc	IN	9/30/96	$68,228	$64,836	$62,437	$57,804	$53,686	$306,991
American Student Assist	MA	12/31/96	$166,615	$102,803	$107,218	$94,099	$87,193	$557,928
Educational Credit Mgt Corp	MN	3/31/97	$258,844	$237,705	$215,097	$205,016	$176,781	$1,093,443
Neraska SLP Inc	NE	9/30/97	$167,680	$104,738	$90,475	$85,760	$75,683	$524,336
Education Assistance Corp	SD	9/30/97	$99,320	$81,877	$47,250			$228,447
Texas Guar Stud Loan Corp	TX	9/30/97	$138,597	$113,381	$99,199	$99,199	$99,199	$549,575
NW Education Loan Ass.	WA	6/30/97	$137,037	$134,710	$105,585	$96,317	$94,851	$568,500
Great Lakes High. Ed. Corp.	WI	9/30/96	$218,016	$175,257	$154,002	$154,002	$141,688	$842,965
								$0

7/28/98

SECONDARY MKTS

SECONDARY MARKET	ST	YEAR	TOP	FIVE	ALARIES			TOTAL
		**	1	2	3	4	5	
Southwest Studt Svcs Corp	AZ	9/30/96	$183,750	$136,500	$80,850	$75,600	$73,500	$550,200
CA High Ed Loan Auth	CA	9/30/93	$309,362	$116,219	$88,850	$84,896	$53,170	$652,497
SLF of Idaho Mktg Ass	ID	12/31/93	$93,771	$82,412	$36,300	$33,400		$245,883
USA Group, Inc.(Parent) *	IN	9/30/96	$1,043,838	$598,930	$505,019	$334,983	$304,303	$2,787,073
NELLIMAE	MA	12/31/92	$364,440	$161,709	$97,463	$67,879		$691,491
Maine Ed. Ln Mktg Corp***	ME	12/31/93	$3,700	$3,100	$2,450	$2,000	$1,500	$12,750
NC-College Foundation	NC	6/30/93	$80,779	$67,956	$55,784	$55,076	$54,991	$314,586
Granite State Mgt & Resour	NH	6/30/96	$288,810	$97,440	$76,160	$72,800	$65,240	$600,450
NM Ed Ass Foundation	NM	6/30/96	$105,074	$74,037	$67,603	$66,273	$63,541	$376,528
SC Stdnt Loan Corp	SC	6/30/93	$79,715	$65,431	$61,532	$48,751	$41,700	$297,129
Stdnt. LoanFin. Ass.WA	W	6/30/94	$68,293	$54,938				$123,231
Wyoming Student Loan Cor	W	3/31/96	$68,625	$54,493	$51,299			$174,417
								$0
								$0
*Parent company of secondary market and others								
**awaiting more current information from the IRS for data prior to fy1996								
***Salaries stated as being for time as needed								

7/28/98

UNITED STATES DEPARTMENT OF EDUCATION

THE DEPUTY SECRETARY

July 28, 1998

The Honorable William Goodling
Chairman
Committee on Education and the Workforce
U.S. House of Representatives
2181 Rayburn House Office Building
Washington, DC 20515-8100

Dear Chairman Goodling:

Thank you for your July 22, 1998, letter to Secretary Riley regarding the interest rate on consolidation loans made through the Direct Loan program on or after July 1, 1998. I am sending you this initial response on Secretary Riley's behalf. A similar response is being sent to the other signatories. We will provide you with the remaining information not later than Wednesday, August 5, 1998.

Before I answer your numbered requests for information, I would like to address several points you raise in your introductory remarks. First, I appreciate your support for both the Direct Loan and the Federal Family Education Loan (FFEL) programs. President Clinton, Secretary Riley, and I agree with you that the best interests of students, their families, and taxpayers are served by continuing two strong loan programs and leveling the playing field between them to the extent feasible. I look forward to continuing to work with you toward this goal.

The Administration took a step in this direction by including in our proposal for the reauthorization of the Higher Education Act (HEA) a reduction in the interest rate on FFEL consolidation loans that is the same as that being offered on Direct and FFEL student loans, as well as Direct Consolidation Loans. We urge that the final HEA legislation ensure that consolidation loan borrowers in both programs receive the same low interest rate and that lenders receive a fair return on these loans.

Second, I regret that you apparently regard the reduced interest rate on Direct Consolidation Loans as a "unilateral decision" made by the Department. As you know, the Transportation Equity Act for the 21st Century, which became law in June, provided lower interest rates for new student loans effective July 1. Consistent with the Department's longstanding regulations and policy, the interest rate on Direct Consolidation Loans was also reduced to match the interest rate on new Direct Student Loans. In advance of this action, I sent a letter (on June 19) to the authorizing committee leadership, and Administration officials also met with Subcommittee Chairman McKeon, Ranking Member Kildee and a number of committee staff from both parties to share the Department's plans.

The Department's regulations have consistently provided that the interest rate on Direct Consolidation Loans be the same as the interest rate on new Direct Student Loans made at the same time as the consolidation loans. This rule has been in place since the Department first issued rules governing the Direct Consolidation Loan program in July 1994 and is consistent with the Higher Education Act (HEA).

The reduction in the interest rate also corresponds with the Administration's broader policy of helping families pay for college. The 0.8 percentage point reduction in interest rates is strongly supported by student groups and the higher education community because it will significantly benefit borrowers struggling to repay their loans. For example, the average consolidation loan borrower with a debt of $19,000 will save close to $1,000 over the standard ten-year repayment period.

Third, you raise questions regarding whether the Direct Consolidation Loan program has overcome the problems that hampered it last fall. In the last year, the Department has worked with our loan consolidation contractor, Electronic Data Systems, Inc. (EDS), to redesign and strengthen the direct loan consolidation process. The most important improvements to the consolidation process include:

•**Improving processing speed and accuracy** by re-engineering the process by which the loan holder certifies loan balances and by encouraging electronic data transfer;

•**Improving data accuracy** by obtaining better information early in the process, enhancing data entry procedures, and using the National Student Loan Data System to verify loan information earlier in the application process;

•**Adding contractual, performance-based incentives** to improve performance;

•**Creating new managerial controls and monitoring mechanisms** such as improved tracking of applicant information, new management reports, and quality control measures; and

•**Increasing contractor staff to assure high quality customer service,** including hiring additional systems engineers and consultants with prior student loan industry experience last fall and substantially increasing staff this summer to prepare for a possible increase in demand for consolidation loans.

•**Increasing and reorganizing Department staff** responsible for overseeing the Direct Consolidation Loan program.

As a result, we have materially strengthened the Direct Consolidation Loan program and EDS has been smoothly processing new applications this year. EDS has also substantially improved average processing times, from over 140 days one year ago to well within the industry standard of 60 to 90 days today.

Fourth, I have several comments on your discussion of various statistics regarding EDS's performance. Citing statistics from one of the Department's recent reports to Congress, you state that "the Department's completion rate" for applications received between December 1, 1997, and June 12, 1998, is approximately 58 percent. However, this statistic is misleading because it includes applications that are still within the normal processing time.

For a more accurate indication of EDS's performance, I asked staff to examine EDS's performance on applications that it accepted more than 60 to 90 days ago. Between December 1, 1997, and April 30, 1998, EDS accepted roughly 49,900 applications. As of July 17, 1998, fewer than five percent of these 49,900 loan applications remain to be completed by EDS, and nearly half of these applications have been delayed while waiting for applicants to provide necessary information. All of the rest have either been booked or deactivated because the borrower changed his or her mind.

Finally, your letter says that "the Department is apparently not counting all applications received." I presume that you are referring to those applications that are not accepted because they are incomplete. For example, in order for EDS to process an application, it must include a valid social security number and a signature. As noted on the Department's bi-weekly reports to Congress, these reports include only valid applications. Since EDS cannot process incomplete applications, we believe that this is the most accurate way to report this information.

When EDS receives an incomplete application, it contacts the applicant and solicits the missing information.

Answers to your specific requests for information follow.

1. A list of all direct or indirect public relations efforts to advertise the Department's new direct consolidation loan interest rates, including all press contacts and public pronouncements by Department officials and employees, all public service announcements, as well as any mailings or electronic notifications to financial aid administrators or borrowers. In each instance, please note whether similar efforts were made by the Department to publicize the reduction in FFEL Consolidation Loan rates enacted with the passage of the Emergency Student Loan Consolidation Act of 1997.

We did not issue a news release or proactively seek any media coverage regarding the new interest rate on Direct Consolidation Loans, although some other members of the student lending community chose to mention the lower rates in their own news releases. We did respond in a timely manner to provide accurate information to all incoming press inquiries, as we do with inquiries on all subjects on a daily basis.

Records maintained by the Office of Public Affairs indicate that they provided information -- including written fact sheets and interviews with Department staff -- to the following news agencies upon request: the Associated Press, the Philadelphia Inquirer, the Chronicle of Higher Education, Smart Money, Education Daily, Education Week, Money Magazine, the Washington Post editorial board, Marketplace Radio, Student Lending Update, Time Magazine, MTV, and Roll Call.

Following our standard procedures, the Department also took steps to ensure that our customers receive timely and accurate information. The Department distributed three fact sheets to its customer service representatives who interact with borrowers and financial aid professionals, including employees of the direct loan contractors and the Public Information Contractor (which operates the toll-free number, 1-800-4-FED-AID). We posted these materials to our web site as well as the electronic distribution lists for financial aid professionals that you mention. These materials were provided to your staff on July 2, the same day they were distributed to our contractors. We also posted the federal register notice to our web site, consistent with our standard procedure.

In addition, Department officials briefly mentioned the reduced interest rates to the National Association of Student Financial Aid Administrators and the Higher Education Association of the Rockies in remarks on recent changes in the student aid programs.

Through both our contacts with the media and our public fact sheets, we simply tried to respond to inquiries and provide factual information regarding the interest rates in each program without advocating or recommending either program.

In response to the latter part of your question regarding the new interest rate on FFEL consolidation loans enacted in the Emergency Student Loan Consolidation Act of 1997, the Department noted the FFEL interest rate change in its November 13 news release on the passage of the fiscal year 1998 appropriations bill for the Department of Education. In addition, Department officials provided information to at least the following publications on the Emergency Student Loan Consolidation Act and related issues: the American Banker, the Associated Press, Bloomberg Business News, the Chronicle of Higher Education, Education Daily, and Student Lending Update.

The Department also took steps to ensure that borrowers and financial aid professionals had access to reliable information following the passage of the Emergency Student Loan Consolidation Act. We promptly met with the FFEL community and took action to ensure that our customer service representatives were aware of the new interest rate on FFEL consolidation loans. In addition, we prepared a Dear Colleague letter regarding the new interest rate and procedures that FFEL lenders should follow to consolidate direct loans. The Department made this letter available both electronically via its web site and in paper form by mailing it to a list of 17,000 financial aid professionals.

2. A report of the complaints made against the Department or its servicer since December 1, 1997, related to a consolidation loan application or completed consolidation loan. Please indicate the number of complaints and the general nature of complaints (e.g., incorrect payoff of FFEL loans, delay in payoff of outstanding loans, incorrect balance amount on statements to borrowers, or no statements to borrowers).

We are in the process of conducting a search of our records and those of our contractors, and we will provide this information to you by August 5.

3. Any increase in direct loan consolidation applications experienced to date and the volume of applications expected over the next 12 months.

I have enclosed a table which lists the number of Direct Consolidation Loan applications accepted by EDS each week since December 1, 1997. As you can see, there has been somewhat of an increase in these applications since July 1. Although there may be a further increase in application volume in the future, changes in volume are difficult to predict. Past projected increases in volume have not always materialized. For example, the Department expected an increase in loan consolidation volume in the Fall of 1997 after Sallie Mae discontinued its loan consolidation program, but an increase in applications never materialized.

4. The number of direct loan consolidations expected to be completed by the Department and its contractor for each month starting with July.

The Department's Direct Consolidation Loan contractor, EDS, is now consolidating about 2,000 applications each week. EDS is capable of completing 3,000 consolidations each week, 50 percent more than its current volume. By October 1, EDS could be capable of completing 4,000 consolidations each week, twice as many as it is currently processing.

The Department is also pursuing other means of obtaining additional capacity to process direct loan consolidations, should the need arise. We are examining our options to obtain the services of organizations with closely-related experience and a proven track record of performance, including guaranty agencies and other financial institutions.

5. A report detailing any steps the Department has taken to ensure the readiness of EDS to increase the volume of consolidation loans processed in either its Montgomery, Alabama facility or its Louisville, Kentucky facility.

We have attached great importance at the most senior levels of the Department to preparing for a possible increase in volume. I hold regular meetings on this subject in my office several times each week. I have also communicated my expectations to senior EDS management in meetings and telephone conversations.

In anticipation of a possible increase in volume, the Department and EDS have:

•**Expanded EDS's processing capacity.** This summer, EDS has hired additional staff to enable it to process 3,000 consolidations each week, up from about 2,000.

•**Developed special procedures** to track closely demand for Direct Consolidation Loans and EDS's performance in meeting that demand.

•**Increased monitoring of key indicators** to detect and respond to increases in demand.

•**Established a process to control the flow of "fast track" consolidation applications** from the Department's Debt Collection Services on defaulted loans, if necessary.

•**Trained additional Department staff in direct loan customer service** so that they will be ready to respond to borrower inquiries and help address any difficulties in obtaining a Direct Consolidation Loan, if necessary.

•**Enabled borrowers to download an application** for a Direct Consolidation Loan from the Department's web site and are developing an interactive loan consolidation application on the Web.

You also mention an April report from the General Accounting Office (GAO) titled "Direct Student Loans: Efforts to Resolve Lenders' Problems with Consolidations Are Under Way." As you mention, the authors of this report concede that their research was conducted too early to assess the effectiveness of the Department's efforts to improve this program. The report concludes that "the changes that Education and EDS are putting into place appear to move in the right direction."

Answers to your specific requests for information follow.

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We have asked Price Waterhouse to compile its analysis on these applications into one report, which we will provide by August 5.

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I hope that this letter has begun to answer your questions and I look forward to providing the remaining information you requested.

Sincerely,

Marshall S. Smith

Marshall S. Smith
Acting Deputy Secretary

Enclosures

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June 26, 1998	1,907
July 3, 1998	1,938
July 10, 1998	2,867
July 17, 1998	2,720
July 24, 1998	2,849
TOTAL	**75,917**

*Due to a computer system upgrade, data for most of this week were reported as part of the following week's statistics.

Office of Student Financial Assistance
July 28, 1998

Status of Direct Consolidation Loan Applications
By Month of Receipt[1]

Between December 1, 1997 and July 24, 1998

	Dec.	Jan.	Feb.	Mar.	Apr.	May	June	July	TOTAL
Applications Accepted[2]	5,895	12,715	11,453	10,992	8,848	8,492	10,228	7,294	75,917
In Process[3]	28	150	341	710	1,223	1,959	6,720	6,646	17,777
•Step 1: Obtaining lender certification.	4	12	34	71	119	226	2,135	5,792	8,393
•Step 2: In underwriting process.	1	8	5	7	19	85	834	251	1,210
•Step 3. Obtaining signed promisory note from borrower.	2	16	31	97	234	691	3,148	572	4,791
•Step 4. In ICR process.[4]	21	114	271	535	851	957	603	31	3,383
Deactivated or Withdrawn[5]	588	1,836	1,939	1,809	1,283	1,207	755	21	9,438
Completed (Consolidated or Fully Booked)	5,279	10,729	9,173	8,473	6,342	5,326	27,53	627	48,702

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[1]Each column represents the cohort of applications received during that month. For example, in December, 5,895 applications were received. As of July 24, 5,279 of the December applications have been consolidated (fully booked); 588 have been deactivated or withdrawn; and 28 are in process, which includes applications that were deactivated and later reactivated by the borrower and applications for which the loans have been consolidated (first booked) but the borrower requested within 180 days of the first booking that an additional loan be added to the consolidation loan.

[2]These figures include only applications that have been reviewed and accepted as complete. Every accepted application is either "in process," "deactivated or withdrawn," or "completed."

[3]The "in process" row is the total of all applications in steps one through four. This category includes applications that were deactivated and later reactivated by the borrower, applications for which the loans have been consolidated (first booked) but the borrower requested within 180 days of the first booking that an additional ('supplemental') loan be added to the consolidation loan, and applications that are simply still in process. For example, for the months of December, January and February, 508 of the 519 applications "in process" are either reactivations or supplementals, and all the rest are in the extra step for income contingent repayment.

[4]These applications are for borrowers who have selected or have been assigned the Income Contingent Repayment (ICR) option and are awaiting the approval of the waiver from the IRS or receipt of alternative documentation from the borrower.

[5]An accepted application can be deactivated at any stage in the process if a borrower who has provided incomplete information fails to respond within 21 days to a request for additional information. The application can be reactivated when the borrower provides the requested information.

Office of Student Financial Assistance
July 28, 1998

TWO STUDENT LOAN PROGRAMS
Continuous Improvement through Competition

Since its inception in 1993, the Direct Loan program has inspired improvements in the government-guaranteed loan program. Independent experts agree that students benefit from competing loan programs.

Independent Researchers. A recent independent evaluation by Macro International found a high level of overall satisfaction -- 78 percent of all schools -- with the Stafford loan programs. The study concluded that both loan programs benefit from competition.

- More than half of FFEL schools (56 percent) reported that services from banks and guaranty agencies have improved since the introduction of Direct Loans.
- As Macro writes, these findings suggest that "competition between the Direct Loan and FFEL programs has increased overall institutional satisfaction with the loan programs."
- "According to one school's director of financial aid, 'Once [ED] had two programs going, it was great. It was something that should have been done a long time ago. . . competition keeps [the banks] on their toes,'" the report reads.

FFEL Executives. In a national trade publication, NationsBank Senior Vice President James Gathard said of the Direct Loan program earlier this year, "They are a competitor. They have introduced some ways of doing business and some delivery mechanisms that made the private enterprise wake up a little bit. To be perfectly honest, as a private enterprise we thought we were doing almost an A-plus job. When we stepped back a little bit, we saw some of the things the Department of Education was doing and we realized we weren't. We were doing maybe a B-minus job. It was time for us to step forward and make some improvements or we would lose the business.

"It's been relatively good for the industry, particularly for the recipients in terms of students and schools. They've seen the most positive effects from it."

Consumer Advocates. Elizabeth Imholtz says in *The Guerrilla Guide to Mastering Student Loan Debt*, "I think Direct Lending is the best thing that could have happened to the guaranteed student loan program, because now one program wants to look better than the other and that's a good thing. They're vying with each other to look more consumer-friendly, and we have been able to achieve some very nice things for consumers through that competition."

The Direct Loan Program
High-Quality Service to Students and Schools

July 1998

- The Direct Loan program offers less paperwork and faster service to students and schools than government-guaranteed lenders. For example, the Direct Loan program processes over 98 percent of loan origination records within the first 12 hours after it receives them from schools.

- Because of its quality service, the Direct Loan program now delivers roughly as many student loans as the 15 largest government-guaranteed lenders put together and has captured one-third of the student loan market in just four years. As a point of comparison: nearly nine years after the break-up of AT&T, it had not yet lost one-third of the market share it had as a monopoly.

- As Thomas Moore of Georgia's Valdosta State University says, "When we belonged to the FFEL program, I had two clerks on the phone all day every day trying to find out the status of students' loans, and my President's office was full of students complaining because they could not get their check on time. We joined the Direct Loan program because we could no longer deal with a hundred different banks and a dozen guaranty agencies."

- The Direct Loan program has also inspired improvements in the government-guaranteed loan program through competition, indirectly improving service to students and schools in that program as well.

- According to one NationsBank official, direct loans "introduced some ways of doing business and some delivery mechanisms that made private enterprise wake up a little bit . . . It was time for us to step forward and make some improvements or we would lose the business."

- Customer satisfaction rated very high in both the Direct Loan and government-guaranteed programs during the 1996-97 academic year, according to a recent independent evaluation by Macro International. Among all borrowers, 94 percent of students and 91 percent of parents expressed satisfaction with their overall loan experience. The vast majority of both student and parent borrowers perceived the loan origination process as easy or somewhat easy, with no significant differences between the two programs.

What Financial Aid Administrators Are Saying About The Direct Loan Program

"Since joining the Direct Loan program, the Financial Aid Department of Ascension College has found Direct Lending's origination process to be much less complicated than that of the FFEL program. We have enjoyed our affiliation with Direct Loans and look forward to working with it for many years."

– Midge Jacobson
Ascension College, Gonzales, LA

"In the FFEL program, I became very frustrated with trying to track loans and deal with students in tears on registration day because their paperwork was lost. With Direct Lending, I am in control of the loan process."

– Janice Lindsrom
Stonehill College, North Easton, MA

"Direct Loans is committed to providing good service. Those who are inclined to be critical of direct lending should talk with people in the grass roots -- people who are working directly with the program."

– Paul G. Aasen
Gustavus Adolphus College, St. Peter, MN

"When we belonged to the FFEL program, I had two clerks on the phone all day every day trying to find out the status of students' loans, and my President's office was full of students complaining because they could not get their check on time. We joined the Direct Loan program because we could no longer deal with a hundred different banks and a dozen guaranty agencies.

– Thomas Moore
Valdosta State University, Valdosta, GA

"In my opinion, the implementation of Direct Lending at Central Missouri State University has been a major ingredient in the recipe we're using to dramatically improve the service we provide our student and parent customers. The speed, simplicity, and efficiency that Direct Lending affords the Office of Financial Aid has had a direct and positive impact on the recruitment and retention of students on our campus. It has also helped reduce the number of complaints and negative comments our staff members hear about the complexity of the overall financial aid process. The satisfaction levels of students, parents, and staff members is currently at an all-time high."

– Phil Shreves
Director of Financial Aid
Central Missouri State University

"Boston University was a lender for our graduate students, but we thought it was worth giving up our profits to provide better service to all of our students. We have seen major improvements in the program, particularly in the timely delivery of funds to students."

– Barbara Tornow
Boston University, Boston, MA

Proposal: Mark Zuckerman's Request

Proposed Changes to the Student Loan Programs Estimated Relative to the CBO March 1998 Baseline
The Estimates Below Include the Expected Costs to the Government of the Borrower Interest Rate Caps

(by fiscal year, in millions of dollars)

Eliminate the change in the formula for establishing the variable interest rate on subsidized and unsubsidized student loans and on parent loans which is to take place in July 1998. That change would set the rate at the comparable maturity rate (assumed to be the 10-year bond rate) + 1.00% for student loans and the 10-year bond rate + 2.10% for parent loans. This proposal would set the student loan interest rate formula at 91-day Treasury bill rate +1.70% while the borrower is in school, grace, and deferment and the 91-day Treasury bill rate + 2.30% when the borrower is in repayment. The parent loan formula would be set at the 91-day Treasury bill rate + 3.10%. The borrower interest rate on consolidated loans would not be changed. Lender yields on the loans would be changed to the 91-day Treasury bill rate + 2.20 while the borrower is in school, grace, and deferment, the 91-day Treasury bill rate + 2.80% while the borrower is in repayment, and the Treasury bill rate + 3.10% on parent loans. (Assumes only new loans are affected.)

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	1998-2003 Total	1998-2008 Total
BA	--	700	725	790	845	870	925	970	1010	1050	1095	3,930	8,980
O	--	445	650	695	750	780	820	865	895	935	975	3,320	7,810
Guaranteed Loans													
BA	--	675	705	770	825	850	905	945	985	1025	1065	3,825	8,750
O	--	425	630	675	730	765	800	845	875	915	950	3,225	7,610
Direct Loans													
BA	--	25	20	20	20	20	20	25	25	25	30	105	230
O	--	20	20	20	20	15	20	20	20	20	25	95	200

cys to: Mike Smith
Pauline Abernathy
David Longanecker
Maureen McLaughlin
Diane Rogers
Tom Kelley
Shelley Amdur
James Kvaal

FAX

FYI – Susan Hattan called to emphasize that they are sending this just to be on record in case problems develop, not to make a big stink. Scott

MAJORITY STAFF
SENATE COMMITTEE ON LABOR AND HUMAN RESOURCES

JAMES M. JEFFORDS
Chairman

835 HART SENATE OFFICE BUILDING
WASHINGTON D C 20510
TELEPHONE (202) 224-6770
FAX (202) 224-6510

To: SCOTT F.
Date: 7/31/98
Fax #: 401-1438
Pages: 3 + COVER
From: SUSAN H.

MESSAGE GOOD TO SEE YOU YESTERDAY.
MY CALL TODAY WAS TO GIVE YOU A HEADS-UP ON THE ATTACHED. ORIGINAL MAILED THIS MORNING.

United States Senate

COMMITTEE ON LABOR AND
HUMAN RESOURCES

WASHINGTON, DC 20510-6300

July 29, 1998

The Honorable Richard Riley
Secretary
United States Department of Education
600 Independence Avenue, S.W.
Washington, D.C. 20202

Dear Secretary Riley:

As you know, last year Congress passed the Emergency Student Loan Consolidation Act of 1997 in response to the collapse of the Federal Direct Consolidation Loan Program. At that time, Department of Education staff reported that the consolidation contractor, EDS, was receiving more than 12,000 applications per month and was unable to process these applications in a timely fashion. EDS was instructed to cease to accept loan applications until the backlog of applications was eliminated and other significant problems with the loan consolidation process resolved.

The temporary shut-down of the Direct Consolidation Loan Program, as well as the processing problems which preceded it, created difficulties for thousands of student borrowers and their families. We all remember the compelling testimony of the young couple who lost a mortgage and a house as a result of last year's processing errors. None of us would like to see this situation repeated.

For a number of reasons, we are concerned that student borrowers who wish to consolidate their loans within the Direct Loan program may once again face unnecessary delays and disruptions.

The bi-weekly status reports required by the Student Loan Consolidation Act of 1997 show a disturbing trend regarding the backlog of applications. The Department's contractor has maintained a loan backlog of nearly 17,000 borrower applications since late February and has consolidated more applications than it received only twice since the program was reopened. The most recent report provided to us revealed that, for the two-week period ending July 10, 1998, contractor accepted 1,200 more student applications than it consolidated.

There is a strong likelihood that the current backlog will grow in the near future. For one thing, as we learned last year, applications for loan consolidations tend to be heavier in the fall when recent graduates are coming out of the grace period and entering repayment. In addition, we understand that active efforts are being made to encourage borrowers to submit applications for Federal Direct Consolidation Loans to take advantage of the temporary lower interest rate.

Members of the Committee on Labor and Human Resources have been assured that the Department and its contractor will be able to eliminate the existing backlog and expeditiously process any increase in loan application volume that may occur over the next several months. We are attaching a list of questions which have arisen as a result of these assurances and the bi-weekly reports provided by Department officials. We appreciate your assistance in obtaining responses and look forward to working with you to ensure that students and families receive the quality of service to which they are entitled from both loan programs.

With best wishes

Sincerely,

Jim Jeffords

James M. Jeffords

Dan C.

Dan Coats

1. The status reports currently provided by the Department include only applications which have been determined to be complete. What is the total number of applications that are received from borrowers during each reporting period?

2. The reports indicate that more than 2,000 borrowers have withdrawn their applications. Why are these borrowers withdrawing from the program?

3. The reports indicate that approximately 6,800 borrowers have had their applications deactivated. Last year deactivations were attributed in large part to incomplete applications. What is the reason for these deactivations and how does this rate compare with the FFEL program?

4. How long, on average, does EDS require to consolidate a student loan? What is the "age" of loans contained within the current backlog?

5. What efforts are being made to ensure that borrowers do not become delinquent on their student loans while waiting for the loan consolidation process to be completed?

6. The contractor has maintained a backlog of 17,000+ applications for the past four months. When do you anticipate that this backlog will be eliminated?

7. What volume of loan Direct Loan Consolidation applications do you anticipate receiving each month over the next six months? How many direct loan consolidations do you expect your contractor will complete each month over the next six months?

8. What contingency plans do you have in place should increased application volume begin to overwhelm EDS's capacity to process consolidation loans?

9. EDS was required to perform an evaluation of the 1,000 initial applications to determine whether problems with the loan consolidation process had been sucessfully resolved. Please provide me with the results of this evaluation.

1U2609

United States Senate

WASHINGTON, DC 20510

July 30. 1998

1998 AUG -5 A 10: 01

The Honorable Richard Riley
Secretary, United States Department of Education
600 Independence Avenue, SW
Washington, DC 20202

Dear Secretary Riley:

We are writing to express our serious concern that the recent actions taken by the Department of Education will precipitate another crisis in the management of consolidation loans under the William D. Ford Direct Student Loan Program (FDSLP).

The Department's history of management problems with the FDSLP are well documented. As you know, Congress was forced to act last fall to pass emergency loan consolidation legislation in response to the Education Department's inability to handle the applications in the program. The department was forced to suspend its operations and could not accept any new applications for several months because of a severe backlog in the system.

Despite a current backlog of approximately 16,000 applications, the Department has changed the rate for consolidation loans in a manner that will cause a flood of new applications. This will certainly create a further backlog and will most likely devastate the program once again. Considering that the Department can currently handle only 9,700 applications per month, and there are currently 40 million outstanding loans that would be eligible for consolidation under the new rate set by the Department, it would take the Department years to consolidate the loans of all current, eligible borrowers.

Recent reports on the management of the consolidation loan program create substantial cause for alarm. In a recent GAO Report entitled "Direct Student Loans: Efforts to Resolve Lenders' Problems With Consolidations are Underway", the GAO found that "in several instances EDS (Electronic Data System) charged one borrower for a second borrower's loans." The GAO goes on to cite examples on inaccurate payments being sent to lenders, and EDS paying for the same loan more than once.

In addition to the GAO, the Education Department's own Inspector General was also highly critical of the FDSLP. According to a report issued by the IG on the FDSLP, there were a number of serious problems uncovered. One of the most significant problems is that schools were "not keeping accurate loan records". At one of the 16 schools the report studied, "$280,770 had not been entered into the Direct Loan system." This is troublesome in light of the fact that over 1,200 schools participate in the FDSLP. Further, the enrollment status discrepancy between the schools and the National Student Loan Data system was 71% and nearly 3 out of 4 records were inaccurate.

Not only does the Department's recent action raise serious questions about the ability of the FDSLP to function, but it also raises serious policy issues. Specifically, we believe that the Department's actions undermine the clear bipartisan Congressional policy that the FDSLP and the Federal Family Education Loan Program (FFELP) operate on a level playing field. Since the FFELP consolidation loan rate is set by statute at a higher rate, the Department's action will give the FDSLP a competitive advantage over the FFELP, a program that has been in existence for more than two decades, and provides 7 out of 10 loans in the country. The Department's efforts to essentially refinance all FFELP loans will jeopardize the FFELP and leave schools and students without an alternative to the FDSLP. Considering the problems that have plagued the FDSLP, this is an irresponsible action on the part of the Department of Education.

In light of the severe implication of the Department's recent actions, we believe that the Department should not have initiated this dramatic change in the consolidation loan rate without public notice and comment under the Administrative Procedures Act. Because the Department circumvented this process, there is no record for Congress or the public to fully examine the policy and operational consequences of the Department's actions on this vital program.

We would appreciate a prompt explanation of: 1) how the Department can justify this change when there is evidence of such severe, systemic problems with the FDSLP, and 2) why the Department circumvented the public notice and comment procedures required by the Administrative Procedures Act. We simply cannot allow the Department of Education to put the operation of this program at risk of another shutdown at the expense of the borrowers the Department claims to want to assist.

We have enclosed a list of items and request a response no later than August 7, 1998. Please contact Kourtney Spencer with Senator Nickles at 224-5754 or Colleen Cresanti with Senator Mack 224-05274 with any questions you may have.

Sincerely,

Connie Mack

CONNIE MACK
U.S. Senator

Don Nickles

DON NICKLES
U.S. Senator

PAUL COVERDELL
U.S. Senator

TIM HUTCHINSON
U.S Senator

TRENT LOTT
U.S. Senator

PAT ROBERTS
U.S. Senator

1. A report of the complaints made against the Department or its servicer since December 1, 1997, related to a consolidation loan application or completed consolidation loan. Please indicate the number of complaints and the general nature of the complaints (e.g. incorrect payoff of FFEL loans, delay in payoff of outstanding loans, or incorrect balance amount on statements to borrowers, or no statements to borrowers).

2. What volume of loans does the Department anticipate for the Direct Consolidation Loan Program for each month starting in July 1998 through December 1999? We would like an accounting of the applications you have received to date, and a weekly accounting hereafter.

3. Has the Department anticipated the readiness of Electronic Data Systems Corporation, the Department's contractor, to increase the volume of consolidation loans in either its Montgomery, Alabama, facility or its Louisville, Kentucky, facility?

4. How did EDS end up charging the wrong borrowers?

5. How many times has EDS charged one borrower for another borrower's loans?

6. Has the Department reconciled each borrower's account to ensure they are not being improperly charged?

7. What percentage of payments made on behalf of the Department by EDS were accurate?

8. What is the largest overpayment the Department made?

9. Have all the necessary student loan accounts been properly reconciled?

10. Please explain how loan balances, student status records and audit information is so different.

11. Please report on the accounting practices the Department uses to ensure the accuracy of data at EDS, the DLSS, the institutions in the FDSLP, and the NSLDS.

12. Please explain the process of how the Department reconciles information with the schools in the FDSLP.

13. A list of all FDSLP schools who have reconciled with the Department through the end of the 1997-98 school year (with a year by year breakdown and the total amount each school disbursed).

14. A list of all FDSLP schools who have not reconciled with the Department through the end of the 1997-98 school year (with a year by year breakdown and the total amount schools claimed to have disbursed versus the records of EDS and the DLSS).

15. A school by school breakdown of loan volumes, which indicate the following information in a year by year breakdown from 1990 through the present:

a. The amount of money the school says it disbursed in Direct Loans (including their servicers);

b. The amount of money EDS and Computer Data Science Incorporated claimed to have disbursed to each institution in the FDSLP;

c. The amount of money the DLSS claims the schools have disbursed to borrowers in the FDSLP;

d. The amount of money the NSLDS claims schools have disbursed to borrowers in the FDSLP.

16. How can the Department justify a 50 percent increase in administrative costs over those anticipated in 1993?

17. A full and detailed accounting of every dollar of Section 458 funds authorized and expended from 1992 to present.

SLM HOLDING CORPORATION
11600 Sallie Mae Drive
Reston, Virginia 20193
703-810-7439, Fax 703-810-5031

ALBERT L. LORD
Vice Chairman and CEO

April 16, 1998

The Honorable Richard W. Riley
Secretary
U.S. Department of Education
600 Independence Avenue, S.W.
Washington, DC 20202

Dear Secretary Riley:

After several meetings between the staffs of our two organizations regarding emergency plans for the student loan program, I thought you should know how unrealistic I believe the proposals we have received to date have been. Department of Education officials have indicated to us that they intend to secure billions of dollars of lending commitments to provide loans through the lender-of-last-resort program in the event the July 1st structural change in student loan interest rates is not repealed.

The scope of this emergency support would be up to $5 billion for approximately two million students, mostly attending two-year colleges and trade schools. The lender-of-last-resort program was never designed to provide such massive support. The proposed implementation would create significant operational and access issues and cripple the very successful private sector Federal Family Education Loan Program. Worse, these preparations will distract both the Administration and the Congress from the real answer, the timely repeal of the July 1st law.

The Student Loan Marketing Association, Sallie Mae's GSE subsidiary, stands ready to provide up to $200 million in student loans under its existing lender-of-last-resort commitment which runs through December 31, 2000. We are prepared to provide additional support on reasonable terms and within reasonable operational limits. Sallie Mae would incur a substantial loss on every lender-of-last-resort loan it would make under the Department's current proposal that we provide up to $1 billion in financing. As a publicly-owned company, we have a fiduciary responsibility to our investors to protect their capital. As a GSE, we have a responsibility to ensure the financial safety and soundness of the company. To compel us to make loans under the proposed conditions would compromise those responsibilities and would, in our opinion, be an unconstitutional taking.

Department officials have indicated they seek support from various FFELP guaranty agencies as well as Sallie Mae, noting that the direct loan program is incapable of meeting the anticipated need. As described, this approach would be extremely costly to taxpayers. Your staff has indicated that the government would advance between $2 and $5 billion of Department of Education funds to the guarantee agencies for this purpose. Such an amount would represent a substantial portion of the budget surplus that the Congressional Budget Office is now projecting. Moreover, such advances would be expended without Congressional review or approval and would, of course, preclude that portion of the surplus from being used for any other purpose, including the protection of Social Security.

Every day that goes by with this problem unresolved means greater uncertainty for students and their families. The Congress is headed in the right direction by working on a bipartisan solution. Sallie Mae believes that student borrowing rates should be reduced at least as much as suggested by Vice President Gore. We recommend that the legislation incorporating the 0.80% student interest rate reduction be supported by Congress and the Administration. We also support maintaining the lender rate provision contained in Congressman Kanjorski's bill (H.R. 3291) and urge the Administration, together with the student loan industry, to pursue Senator Kennedy's suggestion regarding the development of a market-based mechanism to set lender rates.

I trust you will understand the untenable position in which your staff proposes to put us and the need to ensure continued progress on this vitally important issue. I would be pleased to meet with you as soon as possible to discuss this matter in greater detail.

Sincerely,

Albert L. Lord
Vice Chairman and
Chief Executive Officer

cc: The Honorable James M. Jeffords
The Honorable Edward M. Kennedy
The Honorable William L. Clay
The Honorable William F. Goodling
The Honorable Dale E. Kildee
The Honorable Howard P. "Buck" McKeon

SallieMae

NEWS RELEASE

Contact:

Denise Rossitto
202/298-2901
Fiona Adams
202/298-2903

Student Loan Marketing Association Urges Administration To Support Legislative Solution

Reston, VA, April 16, 1998 — The Student Loan Marketing Association (SLMA), the government sponsored subsidiary of SLM Holding Corporation, today urged Secretary of Education Richard Riley to support legislation that would give students a 0.80% reduction in student loan interest rates. SLMA also advised the Secretary that it is prepared, under its current contract with the Department, to provide up to $200 million of emergency support as a lender-of-last resort. SLMA is prepared to provide additional lending support on reasonable terms.

Access to loan capital is threatened for some students and schools because of a change in interest rates which is scheduled to go into effect July 1. This change could force lenders to cease making small, high-risk loans. The Department of Education has estimated a potential $5 billion loan access problem, which would affect two million students, most attending two-year colleges and trade schools, and has made recent attempts to secure emergency lending support from SLMA and certain guarantee agencies.

"The Administration and Congress must act soon to ensure uninterrupted access to student loans during the coming academic year," said Paul Carey, President of SLMA. "To create a massive emergency funding mechanism at this late date is operationally unrealistic and would leave the entire student loan delivery system in chaos. We estimate it could cost taxpayers more than $2 billion."

The Congress created lender-of-last-resort programs so that SLMA and the guarantee agencies could make student loans to those individuals who do not have access to funds under the Federal Family Education Loan Program. Historically, the lender-of-last-resort authority has been used in isolated circumstances; since 1993 SLMA has only made $21 million in these types of loans.

###

FAX TRANSMISSION

U.S. DEPARTMENT OF EDUCATION
Office of Legislation and Congressional Affairs
600 Independence Ave., SW, Room 6337
Washington, DC 20202-3100
(202)401-1028
Fax: (202)401-1438

Date: 6/29/98 Fax: 456-2223

To: Bob Shireman

Office of :

From: [illegible]

Number of Pages (including cover sheet): 3

If there are any problems with this transmission, please contact me at:
(202)401-0020

Comments:

Sallie Mae amendment they are trying to get into the Senate bill, FYI.

Section 440 of the Higher Education Act is amended by adding a new subsection (j), as follows:

"The provisions of section 18(s) of the Federal Deposit Insurance Act shall not apply to any arrangement between the Holding Company (or any subsidiary of the Holding Company other than the Association) and a depository institution if the Secretary of the Treasury determines that (a) the wind-down of the Association in accordance with the requirements of this section will not be adversely affected by the arrangement; (b) the Association will not extend credit to, or guarantee or provide credit enhancement to any obligation of, the depository institution; and (c) the operations of the Association will be separate from the depository institution. The Secretary of the Treasury shall promptly respond to any request by the Holding Company for a determination made pursuant to this subsection."

RATIONALE: The Federal Deposit Insurance Act was amended in 1996 to prohibit government-sponsored enterprises (GSEs) from becoming affiliated with depository institutions. The impetus for this legislation did not involve the Student Loan Marketing Association, and the legislation does not address the circumstance of its privatization. This amendment allows SLM Holding Corporation (but not Student Loan Marketing Association, its GSE subsidiary) to enter into an affiliation arrangement with depository institutions so long as the Secretary of the Treasury determines that the successful winddown of the GSE will not be affected and that the GSE will otherwise be separate from the arrangement.

Author: Jon Oberg at WDCB01
Date: 6/29/98 12:16 PM
TO: Marianna_Pierce@labor.senate.gov at INTERNET
BCC: Brian Siegel at WDCE01
BCC: Don Feuerstein at WDCA09
BCC: Maureen McLaughlin at WDCA01
BCC: Pauline Abernathy
Subject: Sallie Mae Amendment

On the Sallie Mae amendment you just faxed and asked for a quick response....

I would not expect ED to endorse an amendment that is a significant departure from the SM privatization act that was passed by Congress not so long ago. That being said, the amendment seems to keep a proper separation between the GSE and any affiliated depository institution, and it seems to give the Secretary of the Treasury the proper authority to make determinations.

But this is basically a matter of GSE regulation and banking regulation, and ED would defer to Treasury on this. Have you sent the amendment to Treasury? I can if you want us to.

You may want to ask more about the background and need for this amendment, and what depository institution is involved. Maureen and I heard last week that Travellers, which just merged with Citibank, has recently acquired (or has tried to acquire) a huge position in Sallie Mae. This amendment might be related to that move. We are trying to check this out.

It's worth thinking about the implications of such a move if it happens and what it means for the student loan market.

We may have more thoughts on this as it circulates around.

that include the yeas and nays on all of the amendments?

Mr. JEFFORDS. No, it did not.

Mr. President, I ask unanimous consent that it be in order to ask for the yeas and nays on the three amendments with one show of seconds.

The PRESIDING OFFICER. Without objection it is so ordered.

Mr. JEFFORDS. Mr. President, I ask for the yeas and nays.

The PRESIDING OFFICER. Is there a sufficient second?

There is a sufficient second.

The yeas and nays were ordered.

Mr. JEFFORDS. So for the information of all Senators, Mr. President, we expect three votes to occur at about 9:45 or 10 o'clock, first on the Kennedy amendment, then the Bingaman amendment, and then on the Harkin amendment.

Mr. HARKIN. Mr. President, I will wrap up my comments on the amendment I offered. Again, Mr. President, I listened to the Senator, my good friend from Indiana, talk about schools choosing to stay out of the Direct Loan Program. Well, I point out that in the first 2 years there was a tremendous increase in schools joining the Direct Loan Program. But then in 1995 Congress began to make all of these threats about ending or killing the Direct Loan Program. So what has happened is that schools are apprehensive about whether or not they want to keep the Direct Loan Program, and that put a dampening effect on the tremendous growth we had in the first couple of years.

Secondly, I can't help but be somewhat amused by all this talk about the private sector—the private sector involved in these students loans. We want this private sector to keep going —this private sector. Let me point out, Mr. President, that the "private sector" involved in this Guaranteed Loan Program gets a subsidy from the taxpayers of this country to the tune of $7.5 billion a year. That is right—this private sector enterprise gets a subsidy from the Federal Government every year of $7.5 billion. Private sector? Hardly. Subsidized sector? Yes.

So all of this talk about this private sector out there in the Guaranteed Loan Program is nonsense. Now, if you want to make it private sector, let's not give them any subsidies. Let's knock out the $600 million to lenders for the special allowance payment. Let's knock off the $3 billion to cover defaults. Let's knock off the $2.5 million for interest subsidy for students. Knock off all that stuff—the $7.5 billion a year in subsidies that we put out for the guaranty loan agencies. If you want to talk about competition, that is fine; I don't mind having competition. In fact, it might be pretty good. But let's keep it balanced.

The point is that this amendment that I have offered for the students cuts their taxes by 25 percent on both the Guaranteed Loan Program and on the Direct Loan Program. It cuts it by 25 percent on both. It keeps them both even in that regard. So if you want to keep competition, I say vote for my amendment. You get a tax cut for the students, which allows them to buy textbooks, and it keeps the Direct Loan Program and the subsidized, private sector Guaranteed Loan Program in balance.

I yield the floor.

The PRESIDING OFFICER. Under the previous order, there will now be 30 minutes, equally divided, on the Kennedy amendment.

AMENDMENT NO. 3119

(Purpose: To provide for market-based determinations of lender returns)

Mr. KENNEDY. Mr. President, I send an amendment to the desk and ask for its immediate consideration.

The PRESIDING OFFICER. The clerk will report.

The assistant legislative clerk read as follows:

The Senator from Massachusetts [Mr. KENNEDY] proposes an amendment numbered 3119.

Mr. KENNEDY. Mr. President, I ask unanimous consent that reading of the amendment be dispensed with.

The PRESIDING OFFICER. Without objection, it is so ordered.

The amendment is as follows:

On page 458, between lines 2 and 3, insert the following:

SEC. 436. MARKET-BASED DETERMINATIONS OF LENDER RETURNS.

Part B of title IV (20 U.S.C. 1071 et seq.) is amended by inserting after section 427A the following:

"SEC. 427B. MARKET-BASED DETERMINATIONS OF LENDER RETURNS.

"(a) FINDINGS.—Congress finds that—

"(1) in the field of consumer lending, market forces have resulted in increased quality of services and decreased prices, and more extensive application of market forces to the Robert T. Stafford Federal Student Loan Program should be explored;

"(2) Federal subsidies to lenders making or holding loans made, insured, or guaranteed under this part should not exceed the level necessary to ensure that all eligible borrowers have access to loans under this part;

"(3) setting the level of lender returns necessary to achieve the objective described in paragraph (2) in statute is necessarily inexact and insufficiently flexible to respond to market forces, and therefore lender returns should be determined through the use of market-based mechanisms;

"(4) alternative market-based mechanisms must be tested before a final selection is made as to the particular mechanism to be used for all loans made, insured, or guaranteed under this part;

"(5) the results of testing alternative market-based mechanisms should be evaluated independently; and

"(6) if the independent evaluation concludes that the testing of alternative market-based mechanisms has been successful, a market-based mechanism to determine lender returns on all loans made, insured, or guaranteed under this part should be implemented as expeditiously as possible.

"(b) JOINT PLANNING STUDY TO SELECT AUCTION-BASED MECHANISMS FOR TESTING.—

"(1) PLANNING STUDY.—The Secretary and the Secretary of the Treasury jointly shall conduct a planning study, in consultation with the Office of Management and Budget, the Congressional Budget Office, the General Accounting Office, and other individuals and entities the Secretary determines appropriate, to—

"(A) examine the matters described in paragraph (2) in order to determine which auction-based mechanisms for determining lender returns on loans made, insured, or guaranteed under this part shall be tested under the pilot programs described in subsection (c); and

"(B) determine what related administrative and other changes will be required in order to ensure that high-quality services are provided under a successful implementation of auction-based determinations of lender returns for all loans made, insured, or guaranteed under this part.

"(2) MATTERS EXAMINED.—The planning study under this subsection shall examine—

"(A) whether it is most appropriate to auction existing loans under this part, to auction the rights to originate loans under this part, or a combination thereof;

"(B) whether it is preferable to auction parcels of such loans or rights, that are similar or diverse in terms of loan or borrower characteristics;

"(C) how to ensure that statutory, regulatory, or administrative requirements do not impede separate management and ownership of loans under this part; and

"(D) what is the appropriate allocation of risk between the Federal Government and the owners of loans under this part with respect to interest rates and nonpayment, or late payment, of loans;

"(3) MECHANISMS.—In determining which auction-based mechanisms are the most promising models to test in the pilot programs under subsection (c), the planning study shall take into account whether a particular auction-based mechanism will—

"(A) reduce Federal costs if used on a program-wide basis;

"(B) ensure loan availability under this part to all eligible students at all participating institutions;

"(C) minimize administrative complexity for borrowers, institutions, lenders, and the Federal Government; and

"(D) facilitate the participation of a broad spectrum of lenders and ensure healthy long-term competition in the program under this part.

"(4) REPORT.—A report on the results of the planning study, together with a plan for implementing 1 or more pilot programs using promising auction-based approaches for determining lender returns, shall be transmitted to Congress not later than April 1, 1999.

"(c) PILOT PROGRAMS.—

"(1) AUTHORIZATION.—

"(A) IN GENERAL.—Notwithstanding any other provision of this title, after the report described in subsection (b)(4) is transmitted to Congress, the Secretary is authorized, in consultation with the Secretary of the Treasury, to begin preparations necessary to carry out pilot programs meeting the requirements of this subsection in accordance with the implementation plan included in the report.

"(B) DETERMINATION.—Before commencing the implementation of the pilot programs, the Secretary shall determine that such implementation is consistent with enhancing—

"(i) the modernization of the student financial assistance delivery systems;

"(ii) service to students and institutions of higher education; and

"(iii) competition within the program under this part.

"(C) IMPLEMENTATION DATE.— The Secretary may commence implementation of the pilot programs under this subsection not earlier than 120 days after the report is transmitted to Congress under subsection (b)(4).

"(D) DURATION AND LOAN VOLUME.—The pilot programs under this subsection shall be not more than 2 years in duration, and the Secretary may use the pilot programs to determine the lender returns for not more than 10 percent of the annual loan volume under this part during each of the first and second years of the pilot programs under this subsection.

"(2) REQUIREMENTS.—In carrying out pilot programs under this subsection, the Secretary—

"(A) shall use auction-based approaches, in which lenders bid competitively for the loans under this part, or rights to originate such loans (such as a right of first refusal to originate loans to borrowers at a particular institution, or a right to originate loans to all such borrowers remaining after a right of first refusal has been exercised), as the Secretary shall determine;

"(B) may determine the payments to lenders, and the terms, applicable to landers, of the rights or loans, as the case may be, for which the lenders bid; and

"(C) shall include loans of different amounts and loans made to different categories of borrowers, but the composition of the parcels of loans or rights in each auction under a pilot program may vary from parcel-to-parcel to the extent that the Secretary determines appropriate.

"(3) VOLUNTARY PARTICIPATION.—Participation in a pilot program under this subsection shall be voluntary for eligible institutions and eligible lenders.

"(4) INDEPENDENT EVALUATION.—The Secretary shall enter into a contract with a non-Federal entity for the conduct of an independent evaluation of the pilot programs, which evaluation shall be completed, and the results of the evaluation submitted to the Secretary, the Secretary of the Treasury, and Congress, not later than 120 days after the termination of the pilot programs under this subsection.

"(d) CONSULTATION.—

"(1) IN GENERAL.—As part of the planning study and pilot programs described in this section, the Secretary shall consult with lenders, secondary markets, guaranty agencies, institutions of higher education, student loan borrowers, other participants in the student loan programs under this title, and other individuals or entities with pertinent technical expertise. The Secretary shall engage in such consultations using such methods as, and to the extent that, the Secretary determines appropriate to the time constraints associated with the study and programs. The Federal Advisory Committee Act (5 U.S.C. App.) shall not apply to such consultations.

"(2) SERVICES OF OTHER FEDERAL AGENCIES.—In carrying out the planning study and pilot programs described in this section, the Secretary may use, on a reimbursable basis, the services (including procurement authorities and services), equipment, personnel, and facilities of other agencies and instrumentalities of the Federal Government.".

On page 457, line 23, strike "The" and insert "Except as the Secretary of Education may otherwise provide under section 427B of the Higher Education Act of 1965, the".

On page 505, strike line 5 and all that follows through page 506, line 16.

Mr. KENNEDY. Mr. President, as I understand it, we have a half hour evenly divided, and I yield myself 7 minutes.

Mr. President, this was a very good segue—listening to the comments of my friend and colleague from Iowa—to the amendment which I propose this evening and which has the administration's support.

The amendment I am offering will enable the Department of Education, working with the Secretary of the Treasury, to conduct a pilot program on methods to rely on competition to set interest rates on student loans. The results of this pilot program will be reported back to Congress within 120 days after the end of the test, and Congress must act again before any further action to implement competition on a wider scale.

The bill currently calls on the Secretary to study the feasibility of using competition. That is too little and too late. It is a further delaying tactic. My amendment takes the reasonable step of authorizing a pilot program to see how competition would work in practice.

The obvious way to use competition is through an auction. Under this amendment, up to 10 percent of the loan volume can be auctioned in each of 2 years. Students will be protected with the same low interest rate in the bill, and access to loans will continue. Colleges will participate on a voluntary basis. No one will be forced to be part of a pilot project. After the pilot is completed, an independent entity will evaluate the results and submit them to the Department of Education, the Treasury, and Congress. For example, one type of auction could invite lenders to offer loans to all eligible students at a college, or a group of colleges; or a State could originate loans for students at colleges in the State and auction the loans afterward, with excess subsidies returned to the Federal Government.

The pilot project would be able to assess the practical problems, if any, in this procedure. In fact, there is already experience to build on. Loans for students in the health professions were conducted by auctions. Before the initial auction, the interest rate was based on a 91-day Treasury bill rate plus a premium of 3 percent. At the final auction, the premium was 1.5 percent—a significant cut in the interest rate that brought major savings for the students. According to the Treasury, lenders will make an average return of 16 percent on student loans under this bill, a higher rate of return than their historic rates of return on their other assets, even though these loans are guaranteed by the Federal Government and therefore have no risk to the banks.

As the Congressional Budget Office analysis of March 30, 1998, concludes, "banks do not require the same returns on FFELs that they require overall, since federally guaranteed student loans are less risky than the average bank asset." The excessive cost to the taxpayer of these artificially high interest rates is at least $1 billion over the 5 years.

Mr. President, we all know what is going on here. A Washington Post editorial of March 18 is titled "Stared Down by the Banks," and it pulls no punches and it accuses Congress of being intimidated by the banks. A USA Today editorial of March 23, 1998, is titled, "Banks Acting Like Bullies"—too much subsidies for the banks. Clearly, we should let competition set the interest rate, not Congress.

As the Los Angeles Times said in its editorial on June 5, "Congress should tackle the 'larger problem: the lack of competition in the student loan system.'" This amendment that I am offering this evening is a worthwhile pilot program that can help do so.

Competition can work and will work to save Federal dollars and save dollars for college students as well.

Mr. President, I ask unanimous consent to have printed in the RECORD the various Federal programs that are involved in this kind of a competition.

EXAMPLES OF HOW AUCTIONS ARE USED IN FEDERAL PROGRAMS

Treasury Securities.—Treasury auctions bills, notes, bonds and inflation-indexed notes and bonds in a sealed-bid auction. Bidders bid an interest rate and loan volume they would like at that rate. But no bidder can win more than a certain percentage of the total put up for bid. Noncompetitive bidders can submit pre-auction bids for a given volume for which they'll accept the auction-determined interest rate. Treasury usually uses discriminatory-price auctions by giving each bidder the rate they bid, but it has also experimented with uniform auctions in which all winners get the highest winning rate.

HUD Loan and Real Estate Asset Sales.—HUD and FHA auction defaulted mortgages, and bidders may bid on any number of mortgages. Because any combination or all of the auctioned items can be bid on together, there is likely overlap in the mortgage packages submitted by each bidder. To address this problem and to be able to determine which combination of bids would optimize value for the government, an Auction Optimization Model was developed by AT&T Bell Laboratories. The computer model is used to select the winning bids based on total revenue for the government.

Health Education Assistance Loans (HEAL).—HHS conducts a sealed-bid auction in which bidders bid an interest rate and loan volume they would like at that rate. The low bidder and all others within a certain tolerance of the low bid win the right to make loans. In the case of single winners, schools would not have a choice in that given year and might have to deal with different lenders in each year. In the case of multiple winners, each bidder would have to compete to make as many loans as they can, though it would probably be less than their originally bidded volume.

FCC Wireless Spectrum Auctions.—The FCC conducts sealed-bid auctions for spectrums in which hundreds of markets are determined simultaneously. After each round, bidders see the prevailing price in each market and can place a bid in the next round in markets they had not bid for previously. The auction does not end until no more bidders want to make higher bids in any market. Telephone service provision is also auctioned in certain areas, including relatively unprofitable parts of areas. Though results have been mixed, most auctions have gone well.

Elk Hills Oil Field of the Naval Petroleum Reserve.—Elk Hills was one of the federal government's largest privatization efforts, with the sale completed in February of 1998.

The process involved getting five independent evaluators to determine the value of the property before publishing the offer and collecting proposals from potential bidders. Due diligence and close attention to transfer documents were components of the many legal and technical steps. The bid evaluation incorporated negotiations with the three finalists on terms beyond the payment, such as environmental indemnity issues, and ultimately a single winner was selected.

WIC Infant Formula Bidding Process.—WIC purchases of infant formula comprise more than half of all formula sales within the U.S., and in an effort to ensure competitive pricing, in 1989 the federal government began requiring states to establish competitive bidding processes. The firm offering the lowest net price to the state or cluster of states wins the exclusive right to sell infant formula to WIC participants, and that firm is then billed by the state WIC agencies for rebates on formula purchased with WIC vouchers. Under this system GAO reports that after accounting for rebates in 1996, WIC agencies paid 85 percent less than the wholesale price for formula, on average, allowing WIC to be extended to an additional 1.7 million persons each month.

EPA Pollution Rights.—EPA's acid rain program holds an annual auction of a Special Allowance Reserve of approximately 2.8 percent of total allowances, conducted by the Chicago Board of Trade. In addition to providing an additional means of obtain allowances (each equal to one ton of annual SO_2 emissions), the auction also importantly establishes a market price signal. Allowances are sold from the Reserve before private holdings are sold. Anyone—including public interest and environmental groups—can participate in the bidding on and trading of allowances. Spot (for that year) and advance (not usable for seven years) allowances for SO_2 emissions are available through the auction, and allowances may be bought, sold, banked, or retired. This auction appears to use discriminatory pricing rather than uniform pricing.

Resolution Trust Corporation.—RTC auctions collateralized and uncollateralized assets. For example, in a recent competitive (sealed) bidding process, approximately 1100 assets were divided into 30 pools based on asset type and region. A financial advisor and due diligence contractor scrubbed the relevant files and collected data to establish values and reserve prices for each asset. This information, recorded in CD-ROM format, was made available to the public, which had four weeks to review it. Bids on the 30 asset pools were received at a centralized New York clearinghouse over a two-day span. Based on the best and final bids, the $450 million sale yielded 87 cents on the dollar rather than the 75 cents that the portfolio had originally been valued at.

Oil and Gas Sales on the Outer Continental Shelf.—After determining to lease the tracts, they are advertised in the Federal Register in an open bidding process. Potential investors send their checks; after the highest bidder is notified of their acceptance, the other checks are returned to the unsuccessful bidders. At this point, the government conducts its own assessment of the value of the oil and gas reserves, based on geological and mineral information provided by the successful bidder, to make sure the bidded amount meets or exceeds the government estimated value.

Conservation Reserve Program (CRP).—The USDA solicits bids from producers for enrollment of acres into the CRP. Bids are accepted based on a formula that accounts for the environmental for each dollar from enrollment (i.e., if a bid is accepted, the government pays farmers rental payments for 10 years to idle their land and put a conserving cover crop on it).

Timber Sales.—The Forest Service auctions off the rights to timber companies to cut designated areas in National Forests. After an offer of sale describing the timber and the sale terms is publicized, a sealed-bid process takes place. Non-price related terms of the sale, including environmental concerns, are all set by the government, so the highest bidder wins the auction.

Export Enhancement Program (EEP).—The USDA establishes prices and bonus levels based on their estimates of the going market rates, and then accepts bids from exporters. However, rather than bidding against each other in a true-market scenario, exporters are really only bidding against the government-set price and bonus level, and they have the option of coming back with successive new bids until they hit the USDA-determined price levels.

Mr. KENNEDY. We obviously have the Treasury securities that are involved in these kinds of competitions. The HUD loans; the FHA auction on mortgages is a competitive bid; the HEAL loans, the Health Education Assistance Loans; the FCC wireless spectrum auctions. We had a long debate on what was going to be the best way to protect the taxpayer. And the decision by the Congress was to have the spectrum auctions. Elk Hills Oil Field of the Naval Petroleum Reserve was auctioned. WIC, infant formula, there was a bidding process and auctions; EPA pollution rights are auctioned off. The Resolution Trust Corporation relied on auctions, and the auctions were, in their view, based on their best and final bids. The last auction that went off was typical. The $450 million sale yielded 87 cents on the dollar rather than the 75 cents that the portfolio had originally been valued at, and was returned to the Treasury. Oil and gas sales on the Outer Continental Shelf were auctioned off. Conservation Reserve Program auctioned off; timber sales auctioned off; Export Enhancement Program auctioned off.

These are existing Federal programs that use the auction system to provide the best kind of protection to the taxpayers, and in this case to the students.

But this particular amendment says, with the urging of the Administration, let's have a pilot program independently evaluated, the result of which is submitted to the Congress, the Administration, and made public. Then the Congress can make a judgment on this matter.

I hope our friends on the other side of the aisle who talk about market forces and are constantly lecturing Members will support this very modest recommendation. This amendment is built on market forces and built on competition. It follows the kinds of recommendations which the U.S. Government has accepted in terms of auctions.

All we are doing is saying let's have a pilot project and test how this program would work in terms of protecting student loans. We have had debates here tonight on the level of interest rates. We have had debates in our committee on the level of interest rates. Let us try in terms of protecting students to give them the best deal that they can possibly have, and use these resources to make a major difference in reducing the cost of higher education in this country.

I reserve the remainder of time.

The PRESIDING OFFICER. Who yields time?

Mr. JEFFORDS. Mr. President, I yield myself such time as I may consume.

Mr. President, I rise in strong opposition to the amendment being offered by my colleague Senator KENNEDY. While I share his interest in exploring mechanisms for improving the delivery of student loans, as chairman of the Labor Committee, I strongly oppose his effort to provide the Department of Education—whose desire to disadvantage the FFEL program has been aptly demonstrated—with unbridled authority to conduct an experiment on the FFEL program.

The impetus for this concept arose out of the lengthy deliberations we have had over the past eighteen months about setting the appropriate interest rate for students and lenders. In 1993, when the Student Loan Reform Act was being drafted, its authors—including Senator KENNEDY—anticipated that the Federal government would shift entirely from the FFEL program to the Federal Direct Loan program. A transition provision was included in the law which changed the way that student loan interest rates were to be calculated effective July 1, 1998. This change was primarily intended to reflect the budget scoring needs of the Direct Lending program. The consequences for student borrowers in the FFEL program, however, would have been dramatic.

There is general agreement that, if the interest rate that was set for July 1, 1998 and which was delayed until October 1, 1998 is allowed to go into effect, it will become unattractive for lenders to participate in the FFEL program.

S. 1882, as reported from the committee, confronts the challenge of trying to provide students with the lowest viable interest rate on their student loans while ensuring sufficient lender participation to preserve open and full access to student loans. After nearly a year of consultation with students, lenders, representatives of the higher education community, the administration and financial services experts, the committee put forward a compromise interest rate package.

This package sharply reduced lender yield by 30 basis points while allowing students and their families to enjoy the lowest interest rates in nearly twenty years. The process of developing this package was long and difficult and the stakes were very high. While by no means perfect, the bipartisan compromise meets the twin challenges of low rates for students and continued stability in the FFEL program.

As I wrestled with my desire to balance the twin objectives of reducing the interest rate paid by students and preserving access to loans under the FFEL program, I encountered several budget analysts who were interested in using market-based mechanisms to establish student loan interest rates.

It became clear to me, however, that market-based mechanisms, while attractive a first blush, quickly reveal themselves to be far more complicated to design and implement than is ever fully appreciated. These analysts, who often focus only upon economic considerations, often fail to recognize that student loan programs are designed primarily to offer a social benefit—that is, to offer loans, at reasonable rates, to students without respect to credit history, educational program, loan size, geographic location, or potential as a consumer of future credit products. Market-based mechanisms, if they are to be implemented, must be carefully designed to ensure that all students continue to have equal access to student loans without regard to any particular characteristics of the borrower or their program of education.

Further, any changes to the delivery system for the FFEL program, must strive to preserve the high level of service that students and institutions of higher education currently enjoy. Under an auction model, schools and borrowers may be forced to deal with a different lender and servicer each year. Regional lenders in small states may lose the ability to participate in the program. Students may lose the ability to select the lender of their choice. And equally important, particularly in light of the collapse last year of the Department's loan consolidation program, students may find themselves forced to make payments to myriad lenders each of whom has different practices and procedures. An auction, improperly designed, could add new and unintended layers of complexity to the program.

As a result of these concerns, as well as concerns about the ability of the Department of Education to administer an auction model, the American Association of Medical Colleges and others have publicly stated their deep reservations about moving toward a market-based model. These issues may be resolvable but I cannot support providing the Department with the authority to experiment on the FFEL program until they have been studied and addressed to my satisfaction and the satisfaction of my colleagues on the Senate Labor Committee.

In an effort to answer some of these questions, our bill directs the Secretary of the Treasury to conduct a study of the feasibility of employing market-based mechanisms. After consultation with students, lenders, and institutions of higher education, the Secretary of Treasury is required to analyze the potential impact of these mechanisms on the delivery of student aid, the implications for students and institutions of higher education with regard to access to student loan capital, and provide a plan for structuring and implementing a mechanism is a manner that ensures the cost effective availability of student loans for students and their families. This report shall be provided no later than September 30, 1999.

It is my strong belief that any pilots, if appropriate, should only be developed after careful study and full Congressional participation. In this spirit, S. 1882 contains a provision directing the Secretary of Treasury to conduct a thorough study and report to Congress on the feasibility of designating and implementing market-based mechanisms for setting student loan interest rates. I look forward to receiving this report and working with the Congressional Budget Office, my colleagues in the Senate, and all of the participants in the FFEL and Direct Lending programs to fully assess whether or not market-based mechanisms can contribute to improvements in the availability, cost, and efficiency of the student loan programs.

In closing, I want to make one very important additional point. From all of this talk, one might think that there is a crisis within the FFEL program which we are trying to fix. The FFEL program continues to be the program of choice of the vast majority of colleges and universities. As a result, the higher education community has deep misgivings about the Kennedy amendment because it is concerned that efforts by the Department to conduct experiments upon the FFEL program will disrupt the benefits and services that students and institutions currently enjoy. For all of these reasons, I urge my colleagues to oppose this amendment.

I retain the remainder of my time.

The PRESIDING OFFICER. Who yields time?

Mr. COATS addressed the Chair.

The PRESIDING OFFICER. Who yields time?

Mr. JEFFORDS. I yield the Senator from Indiana such time as he may require.

The PRESIDING OFFICER. The Senator from Indiana.

Mr. COATS. Mr. President, I will be brief. I just want to make a couple points.

Point No. 1, the legislation that is before us, the base legislation, already contains a carefully designed analysis and feasibility study of market-based mechanisms for student loans. The KENNEDY amendment goes much further than that. We have a study in place. We will get the information needed to make a determination as to whether or not we want to move to an auction market-based program.

Secondly, the last thing the Department of Education needs right now is another big responsibility. It can't handle the responsibilities it currently has. It has not been able to successfully manage the Direct Loan Program and the FFEL Program. Why would we want to consider giving it something else to manage?

Let me just cite a few things from the inspector general relative to the Department's administering of the Direct Loan Program. The IG has concluded that audits at 16 direct loan schools found 8 major weaknesses in 16 of those programs. They also stated that in their audit, the weaknesses they found were representative of the majority of direct loan schools. They said:

> They are very likely to exist at these other direct loan schools. The Department reviewed disbursement amounts recorded at one school and found a total of nearly $300,000 hadn't been entered into the direct loan system.

The IG's report said that 3 of the 16 schools maintained excess cash as a result of improper cash management practices.

Let me quote again from the IG's analysis of the department's ineptness in running the programs that it has now. And I quote:

> The Department does not currently have a process in place to match specific drawdowns with specific disbursement transactions.

The IG goes on to say:

> 53 percent of student status reporting was inaccurate. On average 71 percent of student records in the national student loan data system were inaccurate; 58 percent of transactions were not reported by schools through the department in a timely manner.

The IG says that today, if data is not reported timely, due diligence and timeliness of reconciliation of loan data may be adversely impacted.

We probably all remember, or should remember, that in the 1995–1996 academic year, 1 million applications were backlogged at the Department of Education which caused families and students all over the country to be put in a position where they didn't know whether they were going to get a loan or not. Two years later, the Department sent out 2.7 million forms to fill out and had the wrong shading on it, and therefore the forms were not processed right, and they ended up with hundreds of thousands of backlog as a result of that.

This goes on and on and on, the inability of the Department to handle the one-third of direct loans that it now has. So why do we want to throw in another major initiative at the Department of Education. Let them at least get the initiatives that they currently have jurisdiction for under some control. So I would urge my colleagues to join with the chairman of the committee in defeating the Kennedy amendment.

The PRESIDING OFFICER. Who yields time?

Mr. KENNEDY. Mr. President, I yield myself 3 minutes.

The PRESIDING OFFICER. The Senator from Massachusetts.

Mr. KENNEDY. What my friend, the Senator from Indiana, did not point out is that the student loan defaults were 22 percent under the Republican administration, the previous administration, now down to 10 percent, saving hundreds of millions of dollars a year. This debate isn't over the particular administration, because what we are talking about is a very sound idea. Let me give you what Mr. Petri, a Republican in the House of Representatives, said:

> The amendment would end the recurring battle—he has one that would put in place an auction program. Ours is just a pilot program.
>
> The amendment would end the recurring battle between student groups and lenders over the industry on student loans, which results in the price of the private sector services being set by political negotiation without regard to the actual cost of services.
>
> This amendment has the potential of saving the American taxpayers billions of dollars through competition for this profitable business. Up to now, with the exceptions of in-school interest and the overall interest cap, the banks have always received the same interest the students paid on interest loans.

Here is Mr. MCKEON, Republican of California. This is what he says:

> The gentleman is correct that up to now we have tried to figure out how much to pay the lenders for providing student loans in a political negotiation, and we in Congress really have no way of knowing what the right price is.

These are two Republicans who believe in the market system:

> It would be much better if we had a market process to determine rates.

That is exactly what this amendment provides, a test, a pilot. You can't implement it until we vote again, but a test and a pilot make sense for the very reasons two of the most knowledgeable leaders in the Republican Party in the House of Representatives have stated:

> I am interested in working in that direction.

That is in the recent debate and discussion.

Now, Mr. President, I indicated just a few moments ago all the different agencies of Government that use this process, the most significant, obviously, the Treasury, the FHA, dealing with a great deal more amount of funding than we are considering.

Finally, Mr. President, just look at this chart that I have in the Chamber. This represents, according to the FDIC—and my good friend from Iowa was referring to various figures. Under the proposal that we have tonight, the proposal; that is, the bill, will guarantee the return on equity for all commercial banks at 16 percent. This chart here shows what the banks have made from 1958 going up to 1996, and recently, in 1994 through 1996, it has been in excess of 14 percent.

All we are saying, for those Members of the Senate who are concerned about the cost of higher education, is we have an opportunity to do something and do it the old fashioned way—competition; competition, tried, tested, utilized by other agencies of our Government and which effectively works. At least a pilot project; let's give it a try.

Mr. HARKIN. If I could ask the Senator to yield just briefly.

Mr. KENNEDY. I would be glad to yield—1½ minutes to the Senator from Iowa and 1½ minutes to the Senator from Connecticut.

Mr. HARKIN. I just want to ask the Senator again on this chart—this is outrageous—there is the return on equity for commercial banks. For a number of years it averaged about 11, 12 percent. Now it is up over 14 percent. That is a return on equity for banks. Is the Senator saying that this bill that we are passing will guarantee them a 16-percent return on guaranteed student loans?

Mr. KENNEDY. That is the estimate by the FDIC. And was used by the committee.

Mr. HARKIN. Not only do they get the 16-percent guarantee, they get a $7.5 billion subsidy from the taxpayers of this country. So I think the Senator is absolutely right. If they want to be private sector, let's put it out for bid. Some years ago, as the Senator remembers, we put the WIC Program out, the Women's Infants and Children's feeding program out for competitive bidding, good old free enterprise competitive bidding, and we have saved billions of dollars for the taxpayers of this country and improved the program. I think the Senator is right on target on this. If there is so much money floating around here, let's put it out for bid. Let's put it out for good old free enterprise, competitive bidding.

Mr. COATS. Will the Senator yield at that point?

Mr. KENNEDY. I have 1½ minutes left, I believe. Is that right?

The PRESIDING OFFICER. The Senator has a total of 3 minutes left.

Mr. COATS. Could I ask a question, just ask the time? How much time is left on our side?

The PRESIDING OFFICER. The Senator from Vermont has 4 minutes 6 seconds; the Senator from Massachusetts has 2 minutes 53 seconds.

Mr. COATS. Mr. President, I wonder if the Senator will yield me 1 minute on our side?

Mr. JEFFORDS. Yes, you may have it.

The PRESIDING OFFICER. The Senator from Indiana.

Mr. COATS. We may have the makings of a real deal here. From what I hear it is that the Senator from Massachusetts and the Senator from Iowa are willing to put the whole program out for bid. And if we would take the whole program, including what is run by the public sector, maybe we could cut a deal and just turn the whole thing over to the private sector. Is that what the Senator is suggesting?

Mr. KENNEDY. The pilot program, yes. This is for a pilot program. We will have to come back. But to test and put both aspects out, to have it fair.

Mr. COATS. The Senator is extolling the virtues of the market system?

Mr. KENNEDY. That's fine.

Mr. COATS. Let's take the whole program.

Mr. KENNEDY. I am not prepared to take the whole program, Senator. I am talking about a pilot program.

Mr. COATS. I think I have the floor, Mr. President? Do I not have the floor?

The PRESIDING OFFICER. The Senator from Indiana still has the floor.

Mr. COATS. I thank the Chair. Mr. President, I ask the Senator for an additional minute.

Mr. JEFFORDS. I yield the Senator an additional minute.

Mr. COATS. I thought I heard the proposal that the virtues of the market system were so wonderful that the whole thing ought to be put out into the market system, and that is probably a good idea. So why—I don't understand; you can't have it both ways. You cannot try to attract it into the public sector and not provide competition in the Department of Education and yet kick everything else into the free market.

So I am saying we may have the makings of a deal here. If the Senators think the whole thing ought to go in the market, why, we can probably get that done pretty quickly and it might benefit everybody.

I yield the floor.

The PRESIDING OFFICER. Who yields time? The Senator from Massachusetts.

Mr. KENNEDY. Just for 20 seconds, Mr. President. You have to start someplace. This is a pilot program. If the Senator—if we accept this this evening, I guarantee we will work with the Senator from Indiana to try to make any kinds of adjustments in any types of ways to get whatever kind of pilot program that will accurately reflect the market forces on student loans. Whatever way the Senator wants to, we will work with him closely and we will look forward to his vote this evening.

I yield the remaining time to the Senator from Connecticut.

Mr. DODD. Mr. President, I am reluctant to take the time. I am enjoying this going back and forth. I just wanted to add my voice on this. In fact, I think, what the Senator from Indiana may have just proposed, it is unfortunate that it is not in the form of an amendment here. Because I think a pilot program, as one who has supported allowing institutions to make the choices on direct loans and guaranteed loans, that is really the best way to work. Let the marketplace work this out. I would certainly be amenable to such an amendment here.

I think what the Senator from Massachusetts is proposing and offering here is going to be a great asset to all of us. What we are doing right now is guessing. This is a guessing game, and it need not be a guessing game. So we are being asked arbitrarily here to sort of accept some numbers, disregarding what the larger economic picture is across the country.

And by establishing this study with a pilot program, we can come back in 5 years. That is when we come back to this issue. In that window we will be in a far better position to make a determination as to what should be those rates and how the marketplace could work. Why shouldn't we take advantage of that? It doesn't lock us into a particular answer one way or the other. It just gives us the opportunity to try to see if we can't come up with a more reliable, predictable solution as to how these rates ought to be determined.

Given the fact that we hear from the Congressional Budget Office that, under current rates, the banks have earned rates of return on student loans between 16 and 35 percent—by anyone's estimation that is excessive. That is their estimate. Analysts predict that we will lock in generous profits. CBO, the Congressional Budget Office, predicts that the rates of return under the interest rates in the bill will be between 10 and 25 percent. The Treasury Department calculates an average return under the bill of 16 percent. That is really excessive.

So by allowing a pilot program in the marketplace deciding these factors, we are not allowing a situation that costs taxpayers a tremendous amount. We have done so much here to alleviate some of the pressures for students in this bill, it would be a tragedy not to take advantage of doing something for the taxpayers who underwrite this program. I urge we adopt this amendment.

The PRESIDING OFFICER. Who yields time? The Senator from Vermont has 2 minutes 25 seconds.

Mr. JEFFORDS. Mr. President, I will be very brief. What we are faced with here is a bill that says these are ideas we ought to study, but we ought to have them studied not by an agency that is dedicated to killing the program, so we give it to the Department of Treasury. We say here is an idea; study it, and then make recommendations, and then we can maybe go to a pilot if it looks good. You don't give it to an agency who is dedicated to doing the program in unless you obviously want to kill the program. And that is obviously the design here.

I yield the remainder of my time.

The PRESIDING OFFICER. All time has expired. Under the previous order, the question is on the Kennedy amendment, No. 3119.

The yeas and nays have been ordered.

The clerk will call the roll.

The legislative clerk called the roll.

Mr. NICKLES. I announce that the Senator from Texas (Mrs. HUTCHISON) and the Senator from Arizona (Mr. KYL) are necessarily absent.

Mr. FORD. I announce that the Senator from New York (Mr. MOYNIHAN) is necessarily absent.

The PRESIDING OFFICER (Mr. THOMAS). Are there any other Senators in the Chamber who desire to vote?

The result was announced—yeas 39, nays 58, as follows:

[Rollcall Vote No. 192 Leg.]

YEAS—39

Akaka	Feingold	Levin
Biden	Feinstein	Lieberman
Bingaman	Glenn	Mikulski
Boxer	Graham	Moseley-Braun
Breaux	Harkin	Murray
Bryan	Hollings	Reed
Bumpers	Inouye	Reid
Byrd	Johnson	Robb
Cleland	Kennedy	Rockefeller
Conrad	Kerry	Sarbanes
Dodd	Kohl	Torricelli
Dorgan	Landrieu	Wellstone
Durbin	Lautenberg	Wyden

NAYS—58

Abraham	Faircloth	McCain
Allard	Ford	McConnell
Ashcroft	Frist	Murkowski
Baucus	Gorton	Nickles
Bennett	Gramm	Roberts
Bond	Grams	Roth
Brownback	Grassley	Santorum
Burns	Gregg	Sessions
Campbell	Hagel	Shelby
Chafee	Hatch	Smith (NH)
Coats	Helms	Smith (OR)
Cochran	Hutchinson	Snowe
Collins	Inhofe	Specter
Coverdell	Jeffords	Stevens
Craig	Kempthorne	Thomas
D'Amato	Kerrey	Thompson
Daschle	Leahy	Thurmond
DeWine	Lott	Warner
Domenici	Lugar	
Enzi	Mack	

NOT VOTING—3

Hutchison	Kyl	Moynihan

The amendment (No. 3119) was rejected.

Mr. LOTT. Mr. President, I move to reconsider the vote.

Mr. JEFFORDS. I move to lay it on the table.

The motion to lay on the table was agreed to.

Mr. LOTT. Mr. President, first, I ask all the Senators to stay in the Chamber so we can get through the next two votes quickly. The managers have done a good job getting us to the point where we have two more amendments left. There is one other issue that is being worked on, and then we would be ready to go to final passage. If the Senators will stay close, we can get through the two remaining amendment votes in 20 minutes and hopefully be ready to go to final passage after perhaps a brief colloquy right before final passage.

I ask unanimous consent that the next votes in the series be limited to 10 minutes in length.

The PRESIDING OFFICER. Without objection, it is so ordered.

Mr. KENNEDY. Will the Senator yield? Do we have any information on how we are doing on our Patients' Bill of Rights?

Mr. LOTT. I don't believe that has come up today. We have worked on higher education. There is a vision on the horizon of how this could be done. I am sure we will find a way to do that in the next week.

Mr. KENNEDY. You will let us know—next week?

Mr. LOTT. Like to; unless there is obstruction or resistance. (Laughter.)

I am sure when the time comes, the Senator may have some second thoughts.

But at any rate, let's do higher education and then we will talk about that.

AMENDMENT NO. 3116

The PRESIDING OFFICER. The question is on the Bingaman amendment No. 3116, with 2 minutes equally divided.

Mr. BINGAMAN. Mr. President, this amendment is intended to improve the academic preparation of our teachers. This is an area of great concern all around the country. The amendment says to States: You should require an academic major for the people you are training to teach in high schools—that in addition to the education course they take, they should have an academic major. Mr. President, 32 States already have in place this requirement.

What we are saying is that over the next 3 years each State should be able to adopt a plan to get to this same point. It will substantially improve the preparation of teachers at the high school level. It has been shown to do that in the States that have adopted it. I believe this would be a very good policy for us to adopt as part of this bill.

I urge my colleagues to take this opportunity. It will be 6 years, again, before we pass a reauthorization of the Higher Ed Act and we need to get on with the business of improving teaching in this country. This amendment will help to do that.

Mr. JEFFORDS. I must oppose the amendment offered by my colleague from New Mexico. He has done a wonderful job in assisting us in taking a serious look at the problems we have with respect to teachers and whether or not they have a major in the subject which they will be teaching.

The problem with this amendment is that it mandates to the States that they must do something. The bill itself provides incentives for them to make sure that the people wanting to be teachers have studied the things which they will teach. We do it by enticement and through assistance with loan programs—with programs—whereas this amendment would order it done.

It is a mandate, and I think it is inappropriate and that it would be counterproductive.

The PRESIDING OFFICER. All time has expired.

The clerk will call the roll.

Mr. NICKLES. I announce that the Senator from Texas (Mrs. HUTCHISON) and the Senator from Arizona (Mr. KYL) are necessarily absent.

Mr. FORD. I announce that the Senator from New York (Mr. MOYNIHAN) is necessarily absent.

The PRESIDING OFFICER. Are there any other Senators in the Chamber desiring to vote?

The result was announced—yeas 23, nays 74, as follows:

[Rollcall Vote No. 193 Leg.]

YEAS—23

Biden	Bryan	Conrad
Bingaman	Bumpers	Daschle
Boxer	Cochran	Domenici

UNITED STATES DEPARTMENT OF EDUCATION

Office of the Deputy Secretary
600 Independence Avenue, SW
Washington, DC 20202

Telephone Number: (202) ______ Fax Number: (202) 401-9027

FAX COVER SHEET

TO: Bob Shireman

ORGANIZATION:

PHONE: FAX:

FROM: Kristi Kimball

COMMENTS:
Int. Rate Quotes
(we considered using pieces of the two starred quotes -- but the press office and Pauline didn't think they quite hit the mark)

TOTAL PAGES (Including Cover): 3

The Clinton Administration Fought for Cheaper Student Loans

Lenders first proposed an outright repeal of the interest rate cut.
"Repealing the 1998 interest rate change is absolutely necessary to ensure an uninterrupted flow of funds for low-interest FFELP loans."

Paul Tone, UNIPAC Service Corp. (07/22/1997)
Testifying on behalf of the Education Finance Council, CBA, NCHELP, Sallie Mae, and other members of the student loan community

The bankers' efforts were blocked by the Clinton Adminstration and others.
"Lenders have been thwarted again in their effort to persuade Congress to block a change that they say could threaten the survival of the guaranteed-student-loan program.

"For the second time in four months, Congressional supporters of the loan program declined at the last minute to offer legislation that would halt a scheduled change to the formula that is used to calculate the interest rate borrowers pay on student loans. Staff members for those lawmakers said privately that they were reluctant to take such action because they knew it would prompt heated opposition from the Clinton Administration, the higher-education associations, and student-aid advocates who say that blocking the change will cost students billions of dollars.

"... Mr. [John] Dean [of the Consumer Bankers Association] has helped try to persuade lawmakers to block any change."

-- *The Chronicle of Higher Education*
September 26, 1997

Last fall, lenders again sought to repeal the new rate.
"Seeking to preserve a profitable niche, industry officials are asking lawmakers to repeal a law that could force banks out of the student loan business...

"Attention is now focused on eliminating the interest rate provision. Led by Sallie Mae, lobbyists are telling lawmakers that banks will abandon the program if changes are not made."

-- *The American Banker*
December 5, 1997

Last fall, Republicans supported this effort.
"Republicans early next year will attempt to reverse a scheduled change in the interest rate banks and other private lenders charge for new student loans, GOP aides said this week."

-- *CongressDaily (12/17/1997)*

The Administration supported students.
"[Assistant Secretary David] Longanecker reacted cautiously to announced plans by congressional Republicans to halt a planned interest rate cut on student loans -- saying any changes to the loan policy must benefit students first."

-- *CongressDaily (12/19/1997)*

Student were willing to accept a higher interest rate.
"In the absence of any independent analysis of lenders' claims on the profitability of student loans, students demonstrated some willingness to accept slightly higher costs."

-- *Barmak Nassirian, American Association of State Colleges and Universities (03/05/1998)*

Well into this year, many doubted that students would ever see the savings.

"This summer, the interest rate on federally backed student loans is set to drop from the current 8.25 percent to about 6.6 percent, saving student borrowers nearly $400 million. For a student graduating this summer with $15,000 in debt, the change could save $150 off next year's total payments.

"But chances that students will ever see those savings are about as slim as finding a campus parking space during orientation or a private moment in the dorms.

"The nation's biggest student lenders have banded together and are lobbying Congress to scrap the government-mandated cut, which they say will wipe out their returns."

-- *Knight Ridder Tribune Business News (2/27/1998)*

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"[Fritz] Elmendorf, who represents the bankers, says they can take a very slight cut, but said there is still a wide gap between the banks and the student groups' positions on whether and how much interest rates should drop."

-- *Dow Jones News Service (2/20/1998)*

FAX TRANSMISSION

U.S. Senate Committee on Labor and Human Resources
Washington, DC 20510-6300

EDUCATION OFFICE
COVER SHEET
FAX: (202) 224-3533

Date: 7/6/98

To: Bob Shireman, Barbara Chow, Jen Oberg

Fax #: 456-2223 ; 395-5730 ; 401-1438

From: MARIANNA PIERCE

Subject: ATTACK on PILOTS

Pages: ______ (including this cover sheet)

COMMENTS: Thoughts on how to combat this? EFC etc attack on pilots.

If there is trouble receiving this fax, please call (202) 224-5501.

National Council of Higher Education Loan Programs, Inc.
NCHELP
1100 Connecticut Avenue, NW, 12th Floor, Washington, DC 20036 • Tel: 202-822-2106 • Fax: 202-822-2142 • Web site: www.nchelp.org

LEGISLATIVE ALERT

MEMORANDUM

TO: NCHELP Members

FROM: Lisa A. Ross

DATE: June 29, 1998

RE: **HEA AMENDMENTS: Weigh in with Senators at home this week; DC staff also have more free time this week**

You have all been doing a great job contacting your members. However, if you have not reached your member, there is still time to contact your Senator or firm up his or her commitment to vote against the Harkin and Kennedy amendments.

The Harkin amendment eliminates the insurance premium as the only source of guaranty agency revenue to pay lender default claims although it requires that guarantors charge the fee to all unsubsidized and PLUS loan borrowers and send it to the Treasury.

The Kennedy amendment is still a work in progress but is described as some sort of pilot program for market-based interest rates or an auction pilot program.

You will most likely find your Senators in their home state this week. You may be able to meet with them in one of their local offices or chat with them briefly at one of the many functions they will no doubt be attending. Alternatively, you may be able to meet with home state office staff who will be seeing or hearing from the Senator this week while he or she is home. In addition, you may find that the Senator's staff here in DC are not near as frantic as they have been. Congressional recesses often provide a little breathing room. **Keep in mind however**, that staff in both DC and the home state may start taking vacation time later this week to take advantage of the Congressional recess and the Friday Federal holiday. Thus, you may want to call sooner rather than later.

<u>Please let us know if you get any firm answers on how your Senator will vote on the Harkin or Kennedy amendments.</u>

<u>HEA to Senate Floor</u>

From the information we have today, we know that a unanimous consent agreement has been reached on the HEA bill that will permit no more than 14 floor amendments to be offered. We also know that the Senate will reconvene next Monday and start with the VA HUD Appropriations bill which could wrap up on Tuesday sometime. Thus, with a little luck, HEA could come up as early as Tuesday next week.

Education Finance Council

1155 Fifteenth Street, N.W., Suite 8
Washington, D.C. 20005
202/466-8621 FX: 202/466-8643

URGENT LEGISLATIVE MEMORANDUM

TO: EFC Member CEOs

FROM: Kathleen Smith KS

DATE: June 29, 1998

SUBJECT: Auction Proposal

In order to be prepared for the Kennedy Auction proposal that will be offered on HEA upon return of the Senate, it is imperative that you contact your Senate Offices to inquire as to their plan for voting on the proposal. Please call your Senate offices and ask very directly how the Senator plans to vote and then let me know what response was received. Attached for your review are talking points about the amendment as this will serve as another opportunity to make your views known.

I will need who you spoke to and the result of the conversation. You can simply fax this memo back to me at 202-496-0666, or email me at kathleen@edfin.com or call at 202-466-8085 with the information below. Please contact your Senate office by Thursday, July 2, 1998.

Question: Upon consideration of the Higher Education Amendments (S.1882), it is my understanding that Senator Kennedy will offer an amendment to institute an auction pilot within the Federal Family Education Loan Program (FFELP). I am very concerned about this proposal and would like to know how Senator XX plans to vote on such an amendment.

Name:____________________ Organization____________________

Senate Office contacted____________________ Date____________________

Staff Spoken to____________________

Comments of Staff____________________

Student Loan Auctions: Don't Fly Blind

- An auction would be extremely complicated. It would completely eliminate all smaller-scale lenders, which would not be equipped to compete in massive, national loan origination auctions. It would throw out the window 33 years of successful operations of the guaranteed student loan program in favor of an untested, extremely risky idea. Instead of assured access to $25 billion per year in loan capital at reasonable cost, every year would be a complex leap into the unknown.
- Tremendous competition already exists in the private-sector based FFEL Program. Loan providers compete for business with students and schools by offering lower prices and better service. The only "competition" that would be offered by the proposed auctions would be competition to cut quality of services
- Pilot auction programs would put students and schools at risk. A "pilot" program including 20% of FFELP volume will amount to more than $5 billion in loans per year and involve 1 million students and their families. The Education Department already has enough trouble running the Direct Loan program and doing its part in the FFEL Program. How could it possibly launch a third student loan program consisting of two or more billion-dollar "pilot" programs and make them work?
- Loan providers are used to competing and are interested in exploring whether additional market forces can be brought into play. For that reason, it makes no sense to mandate a completely new approach to a $25 billion program before completing a study.
- In any auction system, even a pilot program, lenders could bid on loans at a discount below their face value, meaning federal costs could grow without limit. And the Education Department would have to hire a new bureaucracy to run the auctions.
- Since different lenders could win auctions each year, students would likely have to borrow from a different lender each year, a confusing and cumbersome process.
- The Kennedy Amendment includes only FFELP loans not Direct Loans. The proposal would damage the FFELP, which serves 80% of schools, giving a competitive advantage to the Education Department's troubled Direct Loan Program.
- The Kennedy Amendment, similar to an amendment offered in the Labor and Human Resources Committee markup of S. 1882, puts the veneer of serious study on the reality of giving the Education Department free reign to force all schools and students into 100% Direct Lending in three years.
- Setting up a pilot program without first completing a study of a remarkably complex new concept like the auction eliminates Congress's options. It's like building the prototype for the F-22 fighter, then doing the design work. Like such an F-22, it won't fly.

CONGRESSIONAL BUDGET OFFICE
U.S. CONGRESS
WASHINGTON, D.C. 20515

June E. O'Neill
Director

July 7, 1998

The Honorable Edward M. Kennedy
Ranking Minority Member
Committee on Labor and Human Resources
United States Senate
Washington, DC 20510

Dear Senator:

I am writing in response to your letter of June 4, 1998, which requested the views of the Congressional Budget Office (CBO) on the possibility of using auction-based mechanisms to determine the yields that lenders earn on Federal Family Education Loans. The attached analysis addresses the types of auction-based mechanisms that might be studied and tested and the kind of information that a demonstration or pilot project could provide. Consistent with CBO's mandate to provide impartial analysis, the analysis makes no recommendations.

If you have questions about the analysis or would like further information, please contact me. Your staff may wish to contact Robin Seiler of CBO's Special Studies Division at 226-2844 or Nabeel Alsalam of CBO's Health and Human Resources Division at 225-2639.

Sincerely,

June E. O'Neill

June E. O'Neill

Attachment

cc: The Honorable James M. Jeffords
Chairman

USING AUCTIONS TO REDUCE THE COST OF THE FEDERAL FAMILY EDUCATION LOAN PROGRAM

July 1998

The Congress of the United States
Congressional Budget Office

CONTENTS

SUMMARY

The Federal Family Education Loan (FFEL) program, which encourages private lenders to make federally guaranteed loans to postsecondary students and their families, uses a formula to determine the yield that lenders earn on such loans. That formula effectively sets a price for the services that lenders provide. Recent analyses by the Congressional Budget Office (CBO) and the Department of the Treasury have highlighted two basic problems that result from that price-setting mechanism.

First, the government cannot prevent some low-cost lenders from earning persistently above-normal profits. If the interest rate on FFELs is set too high, the government and students pay more than is necessary to get low-cost lenders to participate in the program. (Such lenders may have low costs per loan because they have large portfolios or lend mainly to students with large loan balances.)

Second, the government cannot ensure that all eligible students can borrow from private lenders. If the yield that lenders earn on FFELs is set too low, some firms will not participate in the program or will choose to do business mainly with schools whose students borrow large amounts (and, thus, have low servicing costs per dollar borrowed).

Both of those problems exist because the government does not have information about lenders' costs, and because those costs vary both among lenders and over time. The problems are inherent in any effort to induce private firms to participate in a market by setting a uniform price to be paid for their services. CBO and the Treasury Department have determined that, because of those problems, the FFEL program costs taxpayers more than is required to achieve its policy objectives.

The government recently lowered the yield that FFEL lenders earn on loans originated on or after July 1, 1998. That rate is scheduled to drop further in October 1998. The controversy surrounding those reductions in lenders' yield, and recognition of the problems with the FFEL program discussed above, have led education policymakers to consider using auctions to bring new market incentives into the program. Auctions would allow lenders to compete by bidding for loan business. Competitive bidding would in effect replace the fixed interest rate formula with a pricing mechanism that would base each lender's returns on its specific costs.

Two models of auctions for the FFEL program have been discussed in the education-policy community. The first model would involve "rights auctions," in which the authority to make federally guaranteed loans to students at specific schools would be sold at auction to lenders that made the most favorable bids. Rights might be sold separately for very large schools and for groups of smaller ones organized geographically or, perhaps, by length of program, average cost of attendance, or

whether the schools were public or private. Students at each school would be directed to the lender that had won the right to make federally guaranteed loans to them. The interest rate formula and the current federal guarantee of 98 percent of loan principal would not be modified.

The rights-auction model would make only one change in the FFEL program —substituting a rights auction for students' choice of lenders. Recent improvements made by schools, guarantee agencies, and lenders in the delivery system for student loans, as well any disadvantages of that system, would be retained. Large-volume lenders might have a competitive advantage in bidding for the authority and obligation to lend to students at schools with which they already do business. Lenders that do a small volume of business or serve students at small schools might have a competitive disadvantage.

A small-scale demonstration or pilot project could produce valuable information about the strengths and weaknesses of rights auctions and about possible approaches to implementing them. Because such auctions would make little change in the current program, lenders would probably participate at a sufficient level to allow a pilot to produce clear results even if it was carried out on a small scale. However, the schools taking part in a pilot would incur costs associated with changing to a new program, and their students would lose the ability to choose their lenders. Thus, the government might have to create financial incentives for schools to participate in order to secure the desired level of activity.

The second model would involve "loans auctions," in which the federal government would mandate and manage the sale of FFELs after they were originated. Currently, many originators sell those loans to secondary-market entities before the borrowers begin repayment. The loans-auction model would replace such voluntary, private transactions with mandatory sales that would occur under close federal supervision. Proponents of that model believe the government could structure the auctions so as to encourage greater competition among lenders and produce more net proceeds to the government than would occur under rights auctions.

The loans-auction model is not fully developed, and significant further refinement would be needed before the model could be tested in a pilot. The model raises two key questions: what entities would originate FFELs and finance them prior to sale, and how would the government determine the amount of compensation those entities received? With respect to the first issue, it would be difficult to use private lenders as originators without overpaying them to some degree, since each firm would have an incentive to overstate its costs and the government would have trouble collecting accurate information. If a new government-sponsored enterprise was created to originate federally guaranteed student loans, it would be likely to have a dominant position in the market. But an absence of competition would dampen the enterprise's incentive to hold down costs. Alternatively, the government could require the student-lending industry to charter a mutually owned corporation that would originate and provide short-term funding of FFELs. The objective would be to structure the ownership and transactions of the corporation so as to give it an incentive to keep costs down, although an absence of competition would make that difficult as well.

With respect to the second issue, it has been suggested that the government would set minimum prices for different bundles of loans to be sold. If the winning bid for a bundle of loans exceeded the minimum price, the seller and the government would each receive a portion of the difference. If all bids were below the minimum price, the seller could retain the loans until the next auction, perhaps with the government providing financing. This approach would require the government to have reasonably good cost information, which would be difficult to obtain from private lenders.

A number of issues related to incorporating auctions into the FFEL program would deserve further study before a pilot began. Those issues include the size of the savings expected to be achieved from auctions, what rules for disclosure of bids would be advisable, the type of auction process most likely to maximize the government's receipts, and the appropriate frequency of auctions. Other important topics for study are the potential effects of auctions on students' access to credit, on their ability to consolidate loans originated under auctions with those originated outside auctions, and on schools, guarantee agencies, and different types of lenders. A final issue that merits consideration is whether possible changes in the terms of FFELs should be evaluated in the context of a pilot.

INTRODUCTION: PROBLEMS WITH THE FFEL PROGRAM

The Federal Family Education Loan (FFEL) program encourages private borrowing and lending to students and their families to help them pay for postsecondary education. Under the program, participating banks and other financial institutions lend money to students at an interest rate that is specified in law and that fluctuates with market conditions. For loans originated before July 1, 1998, that rate equals the yield on 91-day Treasury bills plus 3.1 percentage points. (That rate applies to students once they have left school and have begun repaying their loans. While they are in school, the interest rate is lower.) Lenders have found that rate attractive because the government assumes nearly all of the risk of default by guaranteeing 98 percent of the principal of the loans. That federal guarantee lowers the interest rate that private lenders would need to charge to earn an adequate profit; it also induces them to lend to students who might otherwise not be able to obtain credit. For loans originated on or after July 1, 1998, the interest rate will be slightly lower—equal to the yield on 91-day Treasury bills plus 2.8 percentage points while borrowers are in repayment.

Research by the Congressional Budget Office (CBO) and the Treasury Department has concluded that the FFEL program costs taxpayers more than is necessary to achieve the policy objective of ensuring that all eligible students have access to private credit on affordable terms to finance their education. Most of the budgetary cost of the program stems from the substantial subsidies that are conveyed to students through the government guarantee, from the ceiling that the government imposes on the interest rate paid by students, and from the government's payment of the interest on some loans (called subsidized loans) while students are in school.[1] Lenders earn profits that are higher than normal (in the sense of being more than adequate to attract capital, given the risks of the business) to the extent that their yield exceeds their costs of originating, funding, and servicing the loans. Although the magnitude of above-normal profits for lenders is not known precisely, they probably account for only a small fraction of the budgetary cost of the FFEL program.

A major source of inefficiency in the program is the government's use of a uniform interest rate formula to set the yield that lenders earn on all FFELs. That formula effectively sets a price for the services that lenders provide. Two basic problems result from the price-setting mechanism. First, the government cannot prevent some low-cost lenders from earning profits that are persistently higher than normal. If the government sets the interest rate on FFELs too high, both it and

1. Whenever the yield that lenders are entitled to earn on FFELs under the program exceeds the interest rate paid by students, the government makes special allowance payments to make up the difference. In recent years, those payments have accounted for a small portion of the program's cost.

students end up paying more than is necessary to encourage low-cost lenders to participate in the program. Second, the government cannot ensure that all eligible students can borrow from private lenders. If the yield that lenders earn on FFELs is set too low, some financial institutions will not participate or will do business mainly with schools whose students borrow large amounts (and, thus, whose loans are less costly to service per dollar borrowed).

One source of those problems is the government's lack of information about the costs of FFEL lenders. Another source is the fact that those costs vary considerably both among lenders and over time. Three factors are responsible for that variation. First, although each lender's origination and servicing costs are relatively fixed, at least in the short run, there are significant differences in how much students borrow.[2] Because an FFEL lender earns the same interest rate on loans to all borrowers, it can lend more profitably to students who take out larger loans. Second, significant differences exist in the efficiency of FFEL lenders. More efficient lenders have lower per-loan origination, servicing, or funding costs, often because they have larger loan portfolios that enable them to achieve economies of scale. Third, lenders' costs vary as they adopt new technologies and as conditions in financial markets change.

In the past, the government appears to have set the yield that lenders earn on FFELs high enough to induce the industry to make loans to virtually all eligible borrowers. But that yield has been set higher than needed to encourage participation by low-cost lenders. As a result, such lenders have earned above-normal profits, which has made the program more costly to taxpayers than it would be if each lender earned a yield that reflected its particular costs. No FFEL lender has an incentive to reveal its costs to the government, however, so the government cannot vary a lender's yield based on those costs.

As noted above, lenders' yield on FFELs has been reduced by 0.3 percentage points for loans originated on or after July 1, 1998. That yield is scheduled to drop further—by as much as 1.2 percentage points—in October. Such adjustments, however, cannot correct the problems associated with using a uniform interest rate formula. Within limits, lenders can respond to statutory reductions in the yield on FFELs by lowering their costs. As CBO's March 1998 analysis showed, lenders can reduce their origination and servicing costs by doing business mainly with schools whose students borrow large amounts; they can lower their funding costs by securitizing the loans they make. (Securitization is the process of selling debt securities to investors, with groups of loans serving as collateral for the debt.) To a

2. For example, a March 1998 analysis by CBO estimated that the average level of indebtedness of students leaving four-year colleges (about $12,500 in 1996) is less than half that of students leaving graduate and professional schools (about $26,000).

degree, such behavior lets lenders continue to earn above-normal profits even after their yield on FFELs has been reduced by law. Moreover, even if such reductions do curtail the high profits earned by some low-cost lenders, a sufficiently large reduction might also cause students at some schools to have trouble obtaining private credit.

USING AUCTIONS TO ADDRESS THOSE PROBLEMS

The shortcomings of the FFEL program have raised interest in introducing market incentives that would stimulate competition among lenders. Competition is already a feature of the program in that lenders compete to do business with students who attend specific schools and to consolidate the loans of borrowers who are in repayment. But although such competition can result in better service for institutions and students, and may also lower the interest rates that some low-risk students pay, it does not reduce the cost of the FFEL program to taxpayers. One possible way to lower that cost is to incorporate auctions into the program, with the aim of reducing the above-normal profits for lenders that result from using a uniform interest rate formula.

The Administration and some Members of Congress have suggested that a study be conducted to identify and evaluate the advantages and disadvantages of auctions (and possibly of other approaches to bringing new market incentives into the program). Such a study could consider how auctions would affect all interested parties: students, schools, lenders, guarantee agencies, and taxpayers. The study could be followed by a small-scale demonstration or pilot project to test alternative approaches to implementing auctions. This analysis by CBO provides an overview of how the government could use auctions to increase market incentives in the FFEL program. It examines in a preliminary way the issues that an in-depth study would analyze in more detail, and it discusses the information that could be obtained through a pilot. The analysis focuses on two types of auctions for federally guaranteed student loans that have been discussed in the education-policy community. Those types differ with respect to what the government would sell at auction and how the lending process would be structured.

"Rights Auctions": Auctioning the Authority to Originate FFELs

One type of auction could be added to the FFEL program without changing the terms of federally guaranteed student loans and without imposing significant new costs on students, schools, guarantee agencies, or the government.[3] That type is known as "rights auctions" because the government would auction the authority to originate FFELs to a particular set of students. Each winning bidder would be obligated to serve all of the eligible students to whom it had won the authority to lend. That authority would be allocated by groups of borrowers who matriculated at eligible postsecondary institutions during a particular school year and would last throughout their attendance at those schools. Allowing the winner of each year's auction for a given school to lend to students throughout their attendance at that school would enable the lender to spread its relatively fixed origination and servicing costs over the largest possible loan balances. It would also allow borrowers to make payments to just one lender for each school they attended and would limit the number of lenders that each school had to deal with.

This model of FFEL auctions would be relatively easy to put in place, would require little change in the current delivery system for loans, and would involve minimal additional investment by lenders or the government. The government would continue to rely on the private sector to organize and manage the lending process. However, lenders would compete for business on the basis of the price they paid or received from the government rather than on the basis of their level of service to schools or the terms they offer to borrowers, as is the case today. To monitor lenders' performance, the government could establish a system in which schools and students reported on the quality of service they received.

Bidding in Rights Auctions. One relatively simple approach to taking bids in rights auctions would be to let lenders offer one-time payments to, or receive one-time payments from, the government in exchange for lending authority. Lenders would offer to pay the government for such authority if they expected loans to have relatively high average balances and, therefore, low servicing costs per dollar borrowed. Conversely, lenders that expected loans to have high servicing costs would offer to assume the obligation to lend in exchange for payments from the government. That approach to bidding would allow auctioned FFELs to have exactly the same payment terms as ones originated before auctions began. Thus, all of the loans would be as liquid and marketable in the secondary market as they are today. Other approaches to bidding in rights auctions are also possible and merit further study.

3. Another approach to bringing new market incentives into the FFEL program to lower its cost would be to modify the terms of the loans. Possible changes include removing the ceiling on the interest rate paid by students, allowing each student's rate to be determined by market conditions, and reducing the proportion of loan principal guaranteed by the federal government. A thorough analysis of such changes would have to examine their potential effect on the policy objectives of the FFEL program; it would also need to consider general issues about the appropriate magnitude and targeting of federal subsidies to students and the appropriate roles of federal credit assistance and grants as means of conveying those subsidies. Such a discussion is beyond the scope of this preliminary CBO analysis of auctions.

Two features of rights auctions might tend to lower the bids offered. First, lenders would be uncertain about the volume and characteristics of the loans that would be originated under each auction. Second, firms that were new to student lending might find that acquiring the capacity to originate FFELs was so costly as to deter them from bidding.

Some incumbent FFEL lenders could have a competitive advantage, and others a disadvantage, in bidding for the authority to lend to students at schools with which they now do business. If the authority to lend to students at a particular school was auctioned by itself (rather than with the authority to lend to students at other schools), a lender that now does a large volume of lending to students at that school might be in the best position to make a winning bid. It would already have the capability to originate a large number of loans and also have information on the loan histories of students at the school. Conversely, a small lender that made loans to students at a small school might be at a disadvantage in bidding for the authority to lend to new students at that school if such authority was bundled with the authority to lend to students at many other schools and the lender did not have the additional origination or short-term funding capacity. However, those lenders could serve as contract originators for winning bidders, if such arrangements proved cost-effective. Bidders could plan to use the secondary market to resell loans and to separate servicing and funding from loan origination, as some lenders do under the current program. Over time, the lowest bids would tend to reflect the costs of the institutions that were the most efficient servicers and providers of long-term funding.

Implementing Rights Auctions. The government could implement rights auctions in a number of ways. However, the trade-offs among the different approaches to implementation are not yet clear, which suggests that determining which approach would be most likely to achieve the program's goals is a practical issue that could best be settled through experimentation. Thus, if the Congress wanted to pursue rights auctions in the FFEL program, it would be sensible to conduct a small-scale pilot program to discover the strengths and weaknesses of such auctions, and possible approaches to setting them up, before broadly implementing a full-scale auction system. A pilot could evaluate different designs in terms of how well they promoted the goals of minimizing above-normal profits earned by FFEL lenders, on the one hand, and ensuring borrowers' access to federally guaranteed student loans, on the other.

One issue to consider in designing a rights-auction pilot is whether students who received loans originated by lenders that had submitted winning bids would have the right to consolidate those loans with loans originated outside the pilot. When a borrower consolidates several FFELs into a single loan, any lender holding a loan that is prepaid loses the ability to expense its origination costs over the remaining life of the loan. In the current program, all lenders are on the same footing with respect to that risk, and they can hope that such losses will be balanced by gains from making consolidation loans. However, lenders that had originated loans as part of a pilot would not be on the same footing as lenders that had not: by having bid for and won the right to make loans, they would effectively incur different origination costs than other lenders. Thus, if students retained the ability to consolidate loans originated through a rights-auction pilot, the net proceeds to the government from the pilot could be somewhat lower than what would be expected under a full-scale auction system.

A pilot could evaluate several key issues related to setting up rights auctions. One issue is whether it would be advantageous for the government to solicit separate bids for a right of first refusal to originate loans to borrowers at particular schools, and for the obligation to originate loans to all borrowers remaining after a right of first refusal had been exercised. Some schools might have a mix of borrowers whose loans were expected to produce positive and negative rates of return. Separating auctions of rights from obligations to lend could encourage lenders that specialized in high- or low-return borrowers to bid for authority to lend at such schools. That could result in greater competition and higher net proceeds for the government.

A second implementation issue would be how to bundle together loan-origination authority for sale. Bundling authority from multiple schools by state or geographic region might encourage lenders to serve students at schools that were small or whose students had low average levels of indebtedness. Another option would be to bundle origination rights on the basis of whether the loans were similar or diverse in terms of loan or borrower characteristics. For instance, lenders might offer to pay more for bundles with similar characteristics. Alternatively, it might be advantageous to allow lenders in each year's auctions to tender bids for bundles of their choosing; that way, the bids would reveal the aggregation of origination authority in that year that would maximize the government's net proceeds.

A realistic objective of a pilot program would be to test approaches in order to identify those that seemed most likely to make the transition to a full-scale system as smooth as possible. Obtaining information about how a full-scale auction would affect students, schools, and guarantee agencies would also be desirable. However, the government might need to create financial incentives for schools to participate in pilots in order to secure the desired level of activity, since rights auctions would expose schools to the possibility of having to deal frequently with new lenders. Because rights auctions would make minimal changes in the existing loan-delivery system and require little added investment, even modestly sized pilots would probably indicate fairly clearly the magnitude of the savings to the FFEL program that could result from full-scale implementation. If a number of different approaches to implementing rights auctions were tested through pilots, it might be necessary to auction a significant proportion of the program's loan volume to learn about each approach.

"Loans Auctions": Federally Managed Auctions of Recently Originated FFELs

Increasing the competition among FFEL lenders through auctions can give those lenders more incentive to hold down their costs and induce more efficient lenders to share their savings with the government through the auction process. Some analysts believe, however, that the current structure of the markets for originating, servicing, and funding federally guaranteed student loans might prevent rights auctions from significantly reducing the cost of the FFEL program. Those analysts argue that because new entrants into student lending must incur costs to develop the capacity to originate FFELs, rights auctions might not produce much competition for the authority to lend to students attending many schools, particularly small ones. They also argue that because economies of scale exist in student lending, the segment of the industry that serves schools with large student bodies and whose students borrow large amounts would be likely to consolidate into a small number of lenders that might eventually be able to avoid competing vigorously in the auction process. As noted above, another concern about rights auctions is that lenders would be unsure about the volume and characteristics of loans that would be originated under each auction, which would tend to lower their bids.

Those concerns have led analysts at the Department of Education to develop a second model for FFEL auctions. Under that model, known as "loans auctions," the government would manage the sale of federally guaranteed student loans that had been recently originated by other parties. In managing the sales, the government would aim to structure the markets for originating, servicing, and funding FFELs so as to encourage greater competition among lenders than would otherwise occur. In the industry's current structure, many lenders provide short-term financing of the loans they originate but then, after borrowers leave school but before they begin repayment, sell the loans to secondary-market entities, such as Sallie Mae (the Student Loan Marketing Association), that provide long-term funding of the loans. That process allows banks and other lenders that deal directly with students to specialize in originating FFELs; it also lets secondary-market entities specialize in borrowing large amounts of money and in servicing loans in repayment according to federal regulations. Currently, all sales of federally guaranteed loans are private, voluntary transactions.

The loans-auction model is not fully developed, and significant further study and refinement would be necessary before the model could be tested in a pilot. The model raises two key questions: what entities would originate FFELs and finance them prior to sale, and how would the government determine the amount of compensation those entities received? With respect to the first issue, existing FFEL lenders could perform the origination and short-term funding functions, but it would be difficult to avoid overpaying them to some degree, since each firm would have an incentive to overstate its costs, and the government would have difficulty collecting accurate information.

An alternative would be to give a new government-sponsored enterprise (GSE) the authority to originate federally guaranteed student loans, fund them up to the point at which borrowers started repaying, and then sell the loans at auction under terms specified by the government. The government's implicit guarantee of the GSE's debt would convey subsidies that would probably enable the enterprise to dominate the market for originating FFELs. However, if such a GSE had a dominant market position, the absence of competition would dampen its incentive to hold down costs. This alternative would lack a key feature of the FFEL program—the use of many private lenders—and would somewhat resemble the federal direct student loan program, in which the government originates loans itself and finances them with Treasury funds. It would differ from the direct loan program, however, in that loans would be sold to the private sector, which would finance them over their remaining life.

Another option would be for the government to require the student-lending industry to charter a mutually owned corporation that would originate and provide short-term funding of FFELs. How that would work is unclear, but the objective would be to structure the entity's ownership and transactions so as to give it an incentive to keep down its costs. Achieving that objective would be difficult without competition, however.

With respect to the second issue, it has been suggested that the government, in managing loans auctions, would set minimum prices for different bundles of loans to be sold. If the winning bid for a bundle of loans exceeded the minimum price, the seller and the government would each receive a portion of the difference. If all bids were below the minimum price, the seller could retain the loans until the next auction, perhaps with the government providing financing. This approach would require the government to have reasonably good cost information, which would be difficult to obtain from private lenders.

Proponents argue that a potential advantage of loans auctions is that originators could keep the responsibility of servicing loans that were later sold at auction. This feature, they claim, could increase auction proceeds by attracting bidders that do not have servicing capacity but are interested in receiving interest income and loan principal. But it is not clear how the government could separate servicing and long-term funding of student loans through loans auctions more efficiently than the private sector does now. Servicing and long-term funding are separated today when secondary-market entities securitize student loans they have purchased from originators and when banks securitize loans they have originated. Some originators and secondary-market entities also hire outside servicers to manage their student loan portfolios.

CBO's analysis of the loans-auctions model assumes that, both in a pilot and after a transition to a full-scale system, FFELs sold at auction would have the same terms as ones originated before auctions. That could require the government to keep the bids tendered by specific lenders confidential. If those bids were made public, they would convey information about how much firms were willing to pay for loans sold in the secondary market outside auctions, which could undermine the firms' negotiating position in that market. How keeping those bids confidential could affect the government's net proceeds from loans auctions deserves further study.

Rights auctions, whether as a pilot or a full-scale system, would be less subject to concerns about confidentiality because there is no current market for the right to originate FFELs (since students choose their lenders). The information that bids for lending rights would convey would be only loosely connected to the value of existing FFELs.

OTHER ISSUES TO CONSIDER IN INCORPORATING AUCTIONS INTO THE FFEL PROGRAM

The government's experience with auctions conducted by the Treasury Department, the Federal Communications Commission (FCC), and other agencies clearly indicates that details in the design of auctions can have a significant effect on their proceeds. That suggests that studying design issues for FFEL auctions in more depth before commencing a pilot would be worthwhile. In preparing a study, it might be useful to run computer simulations or conduct experiments to explore the implications of various design features, as the FCC and the National Telecommunications and Information Administration did with the FCC's auctions.

CBO has identified a number of other issues related to incorporating auctions into the FFEL program that would merit further study before a pilot began operating. First, it would be useful to estimate the magnitude of the savings that auctions could be expected to achieve in the program. Although a small-scale pilot would probably shed light on that issue, it would be helpful to make an estimate of the potential savings before a pilot was launched.

A second issue concerns the possible effects that auctions could have on the objective of giving all eligible students access to federally guaranteed student loans. In particular, could reducing lenders' returns lead some current lenders to leave the industry? Would certain types of schools be likely to shift from the FFEL program to the federal direct student loan program because of poor service from private lenders whose profits had been reduced by the use of auctions?

A third issue is the potential effects of auctions on private lenders that specialize in different lending functions or that do small or large volumes of business. How would introducing auctions tend to change the roles of different types of lenders? In particular, how would auctions affect lenders who do small amounts of lending and tend to sell their loans in the secondary market? What business structures would be likely to develop between small and large lenders, or other firms, under auctions?

Additional questions include, What information from auctions would it be advisable for the government to make public or keep confidential? How would alternative disclosure rules affect the willingness of lenders and secondary-market investors to participate in the industry? How far before the beginning of a school year or term would it be advisable to conduct rights auctions? How many rights auctions could practically be conducted at one time? How often should loans auctions be conducted? And what type of auction process would be most likely to maximize the government's receipts?

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Free-Market Ideas Win Support for Overhaul of Student Loans

Republicans and Democrats, colleges and lenders, differ on what the government's role should be

By STEPHEN BURD

References to Adam Smith tend to roll off the tongues of Republican lawmakers when they talk about the guaranteed-student-loan program. The idea of profit-making banks' helping low-income students advance themselves seems a perfect illustration of how corporate interests can serve the public good.

But this spring's fight over the interest rate on student loans has forced the free-marketeers to confront a bracing reality: The loan program they cherish is far less a creature of Adam Smith's "invisible hand" than it is of Uncle Sam's heavy one.

The government sets the interest rate, determines the eligibility of potential borrowers and, in many cases, sets the size of their loans; banks participate largely because they get big federal handouts. And government policies, at both state and federal levels, so greatly affect college budgets -- and, in turn, the setting of tuition -- that they, more than anything else, drive the supply and demand for student loans.

But while the 18th-century Scottish economist's influence on the loan programs has been mostly symbolic, that may be about to change.

An unusual confluence of factors has prompted key lawmakers in both parties, as well as bankers and educators, to push plans that would sharply scale back the government's role in the loan programs.

The goals of the players are different -- and may or may not be mutually exclusive. The Clinton Administration sees a market-based loan program as one in which students would continue to pay a low, government-set interest rate, and banks would compete only to see who could deliver that rate at the lowest cost to the government. Lenders envision a free-market program in which government regulation disappears and economic forces determine interest rates -- and the banks' profits.

Both visions of the future of the loan program depend on curbing government powers selectively. But both visions -- invocations of Adam Smith notwithstanding -- still rely on a continuing federal role. The dispute is over which government powers should stay and which should go.

For the six million students who borrow to pay for college annually, the situation is a textbook illustration of the power of economic decisions. Small changes in interest rates can save individual students thousands of dollars over the years they repay their loans, making it easier for students to enroll in a pricier college or to choose a career with lower pay. But any miscalculation on student-loan policy that discouraged banks from lending to students -- a specter about which Republicans and banks constantly warn -- could leave students scrambling for cash, and colleges scrambling for students.

The loan programs owe their origins to President Johnson. He created the guaranteed-loan program by signing the Higher Education Act into law in 1965.

But for the program's first decade, few lenders wanted anything to do with it. Banks were largely unfamiliar with student loans and believed them to be too costly to administer. At the time, the government paid banks only the interest that accrued on student loans while the borrowers were still in college, along with reimbursements for any loans on which students defaulted.

By 1976, the program was lending $1.7-billion a year to about 1.3 million students. But low-income students and members of minority groups had trouble getting loans. To bolster participation in the program, and the availability of loans to disadvantaged students, lawmakers sweetened the deal for lenders. For example, Congress kept a lid on the interest rate that students had to pay, but lifted the cap on the rate that lenders could earn. The government made up the difference between the rates by providing a "special allowance" to lenders. It also provided them with special fees for collecting on defaulted loans.

Lawmakers also provided subsidies to encourage the growth of state loan-guarantee agencies and secondary loan markets. The guarantee agencies were established to encourage lenders by promising to "reinsure" the loans, so that bankers would be paid quickly for defaults. Secondary loan markets encouraged lending to more students by buying up loans that banks had already made, providing them with more money to lend out.

Since then, the loan program has grown enormously, and so have its costs to the government. Today the program provides more than $30-billion a year to about six million students. In fiscal 1996, the government paid lenders and guarantee agencies $6.4-billion, including $2.7-billion to cover the interest costs of borrowers in college.

Worries about student access to loans all but disappeared. But concerns grew among student-aid experts that banks were getting fat off the loan program -- at the expense of students and the government. In response, the Clinton Administration conceived a new program, designed to provide loan funds directly to students through their colleges, eliminating the role of banks and guarantee agencies.

In 1993, the Democratic-led Congress approved a bill that created the direct-loan program and called for it to replace the guaranteed system entirely. The program expanded quickly, but its growth was cut short when Republicans took control of Congress in 1995. The two programs now co-exist, though not always peaceably.

One provision included in the legislation creating direct lending has come back to bite lawmakers this year. The bill called for changing the formula used to calculate the interest rate on student loans as of July 1, 1998, so that it would be based on the rate for 10-year Treasury notes rather than on the rate for 91-day Treasury bills, as it is now. The change, which aimed to cut the interest rate for borrowers, was intended to reduce the cost to students as the government replaced the guaranteed-loan program with direct lending.

But with the guaranteed-loan program still intact, bankers said the impending change in the rate formula would make it hard for them to raise the money they needed to make student loans. And the drastic cut in interest rates, they warned, would make the loans unprofitable.

In March, the White House made a proposal designed to halt the impending change in the formula, while maintaining the sharp drop in the interest rate for students. The plan would have reduced the profit margin that lenders see on loans by 0.8 of a percentage point.

Lenders accused the Administration of trying to drive them out of the loan program. Student advocates questioned the lenders' claims that they could not afford to drop their rates, since banks were advertising much lower rates for other consumer loans, such as for automobiles.

Reps. Howard P. (Buck) McKeon of California and Dale E. Kildee of Michigan, the senior Republican and Democrat, respectively, on the House of Representatives subcommittee charged with renewing the Higher Education Act, took their own approach. They drafted a plan, which was approved in May as part of the Higher Education Act bill, to lower the interest rate students pay by 0.8 of a point, but to reduce bank profits by only 0.3 of a point. The difference would be made up by a new federal subsidy for banks.

A similar bill has stalled in the Senate as lawmakers look for ways to pay for the new subsidy. A short-term version of the interest-rate "fix," which delayed the change in the interest-rate formula until October 1, was added to a transportation bill that the President signed in May.

Dissatisfaction with the compromise and difficulties in finding the money to pay for it have driven efforts by the Clinton Administration and lawmakers to look for "market-based" solutions.

"Up to now, we have tried to figure out how much to pay the lenders for providing student loans in a political negotiation, but we in Congress really have no way of knowing what the right price is," says Mr. McKeon, a former chairman of the board of a California bank. "It would be much better if we had a market process to determine that."

Possibly the strongest push for introducing market forces into the loan program comes from Sen. Pete V. Domenici, the New Mexico Republican who chairs the Senate Budget Committee. He had refused to allow the Higher Education Act to reach the Senate floor until its sponsors found the funds to pay for the cost of the interest-rate compromise.

To make the compromise more affordable, Mr. Domenici wants to add to the Senate bill a provision that would keep the compromise in place for five years and then set a "window of opportunity for a phase-in of some type of market-based system," says William G. Hoagland, majority staff director of the committee.

"We would like to push this program more in the direction of not having the government set these rates, but to figure out a way in which -- like car loans or house loans -- rates could be established without fixing them in law," Mr. Hoagland says.

Mr. Domenici's plan does not specify how the market-based system would work, but would instead require the Congressional Budget Office, the Treasury Department, and advisory groups to study possible models. The plan envisions putting a market-based system in place by 2003.

The Clinton Administration does not want to wait that long to start testing market-based approaches. In fact, Sen. Edward M. Kennedy, a Massachusetts Democrat, is expected to offer an amendment to the Senate version of the higher-education bill that would begin pilot tests this fall. His amendment, based on a proposal the White House made last month, would give the Education Secretary the authority to run a two-year pilot program, starting in fiscal 1999, to test "auction-based" approaches.

Under the plan, which would apply to as much as a fifth of the volume of the guaranteed-loan program -- the direct-loan program would not be affected -- the Education Department would hold auctions at which banks would compete to control blocks of loans of various sizes and for various types of institutions.

Lenders would not compete on the rate they'd offer to borrowers; that would be fixed at the same reduced level specified in the Higher Education Act bill. The bidding would focus instead on which lenders offered the lowest "returns" -- the cost to the government at which banks offer loans.

The White House believes that the House's interest-rate compromise gave lenders far too generous a subsidy. Forcing banks to compete for the right to make student loans would slash the excess profits that the guaranteed-loan industry is making, Administration officials say.

"It is critical that we move toward a system that relies on market pressures, not political pressures, in setting subsidies for lenders and intermediaries," President Clinton said when he signed the transportation bill that included the short-term interest-rate change.

Mr. Kennedy's amendment calls for the Education Secretary to choose a non-federal entity to evaluate the pilot tests. If the review identified an effective market-based approach, then "it should be implemented as expeditiously as possible."

But lenders and many G.O.P. lawmakers object. They say the Administration's approach is not market-based at all, but an attempt to bleed banks out of the program by drastically reducing their subsidies. Many of them believe that students got a much better deal in the compromise than they would get from the market. And they say that if a market approach is adopted, the interest rate that students pay should be set competitively, too.

"My sense is that this should not be a one-way street," says Mr. Hoagland, of the Budget Committee. "Student *and* lender rates should be set by the market."

While they have not put forward a proposal of their own, lenders reject the auction approach. Instead, they envision even more of a free-market approach, in which banks would compete for borrowers on the basis of the rates and quality of service they offered.

For now, lenders are more interested in defeating Mr. Kennedy's amendment than in detailing their own proposals to overhaul the program. They are not only lobbying lawmakers, but also trying to persuade colleges to oppose the proposal as well, arguing that it would cause the institutions and their students great hardships if enacted. In doing so, they cite the Health Education Assistance Loan (HEAL) Program. Until it was halted in 1995, it made loans to students in medicine, nursing, and related fields, using an auction approach to set both borrowers' interest rates and lenders' returns.

Today, such a lobbying strategy has resonance; medical colleges had long complained about the program. In a letter to Senator Kennedy, Richard M. Knapp, executive vice-president of governmental relations at the Association of American Medical Colleges, said the fact that the auctions took place annually created "year-to-year uncertainty" about lenders and services. He acknowledged that the auction approach had driven down the interest rates that students paid on their HEAL loans, but he complained that colleges couldn't choose the banks they wanted to work with; that students lost track of their loans as banks in the program changed; and that because the banks were unsure whether they would remain in the program each year, the quality of their customer service declined.

Robert Shireman, the White House's senior education-policy adviser, helped craft the Administration's auction-based proposal. He says the lenders are using the HEAL program as a bogeyman to scare colleges. "They want campuses to think that's where we are heading," he says.

The Administration, he says, will try to avoid the pitfalls of the HEAL program in designing its new auctions. For example, a pilot test could be designed so that lenders bid for the right to serve specific colleges, and guarantee that they will hold the loans until the borrowers graduate. That way, students would not see their loans go between lenders while still in college.

Mr. Shireman says he is not surprised that lenders oppose the Administration's proposal. "It's interesting now that the industry, which has always purported to be for competition and for the market, is saying, 'Don't test anything.'"

To his chagrin, however, colleges share many of the banks' worries. They, too, oppose the Kennedy amendment.

"We support efforts to inject market incentives into the guaranteed-loan program," said Barmak Nassirian, a policy analyst with the American Association of State Colleges and Universities. "But we are not convinced that the Administration's plan is the best way to do that."

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Page: A27