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[Direct Student Loan Briefing Book] [binder] [1]

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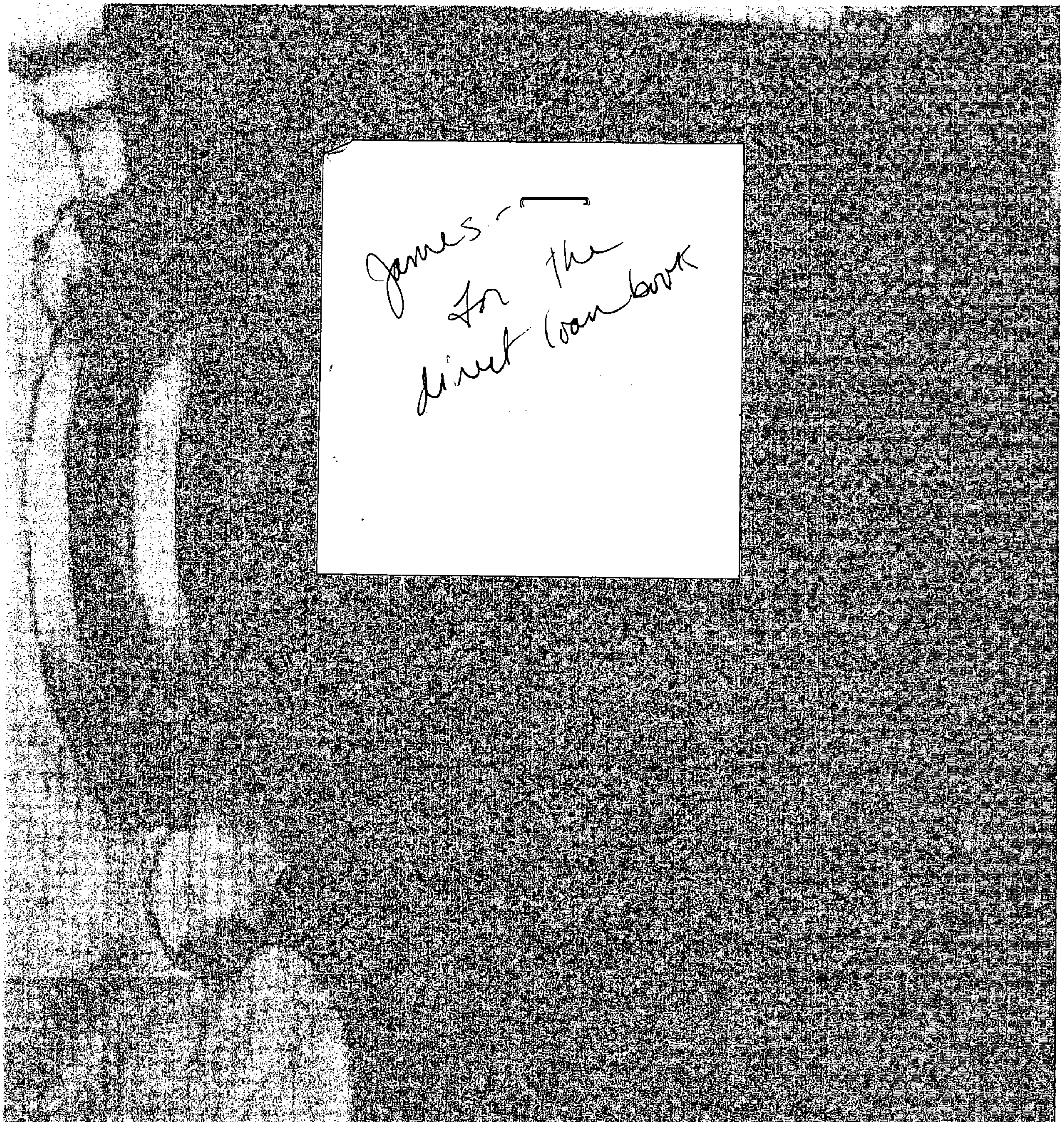
Direct Loans
Briefing Book

James -
For the
direct loan book

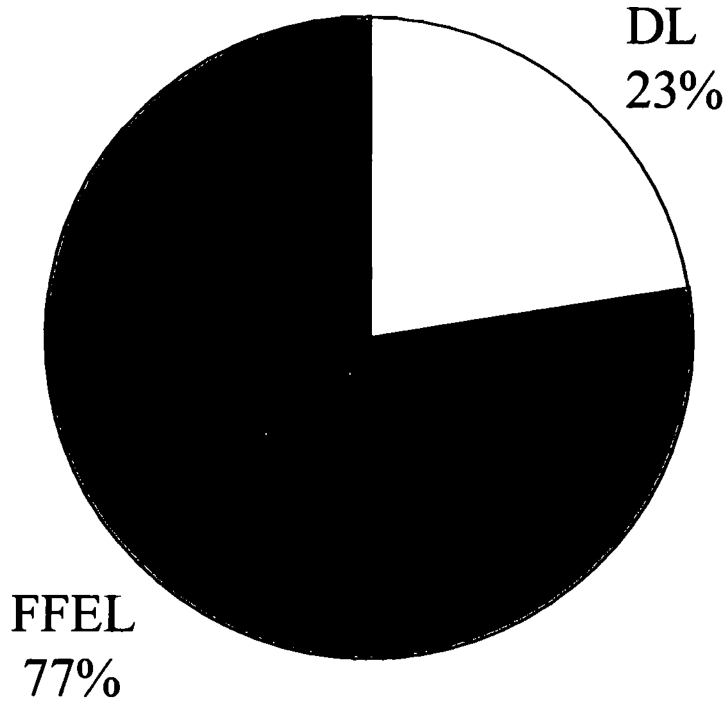


# Direct Loans

## Resource Book

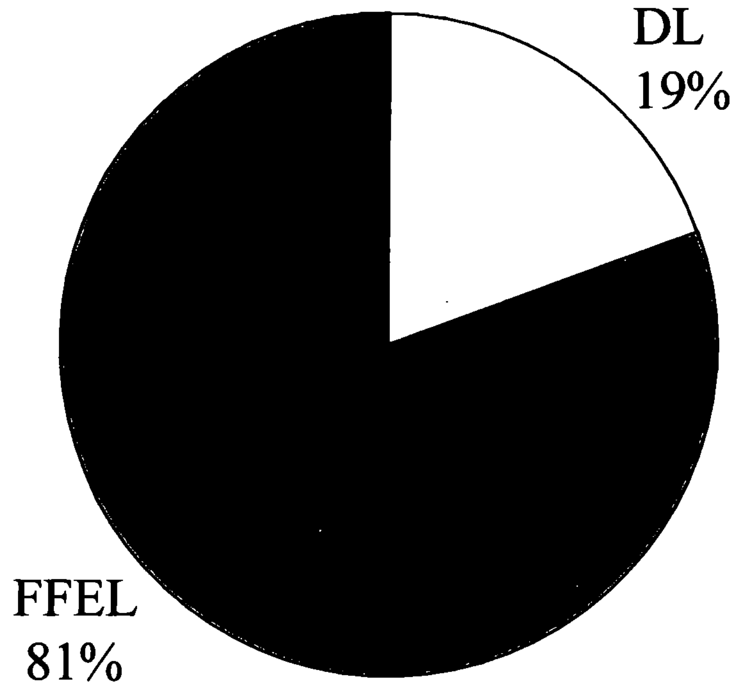
# Consolidation
# DL vs. FFEL
# FY96

## Number of Borrowers



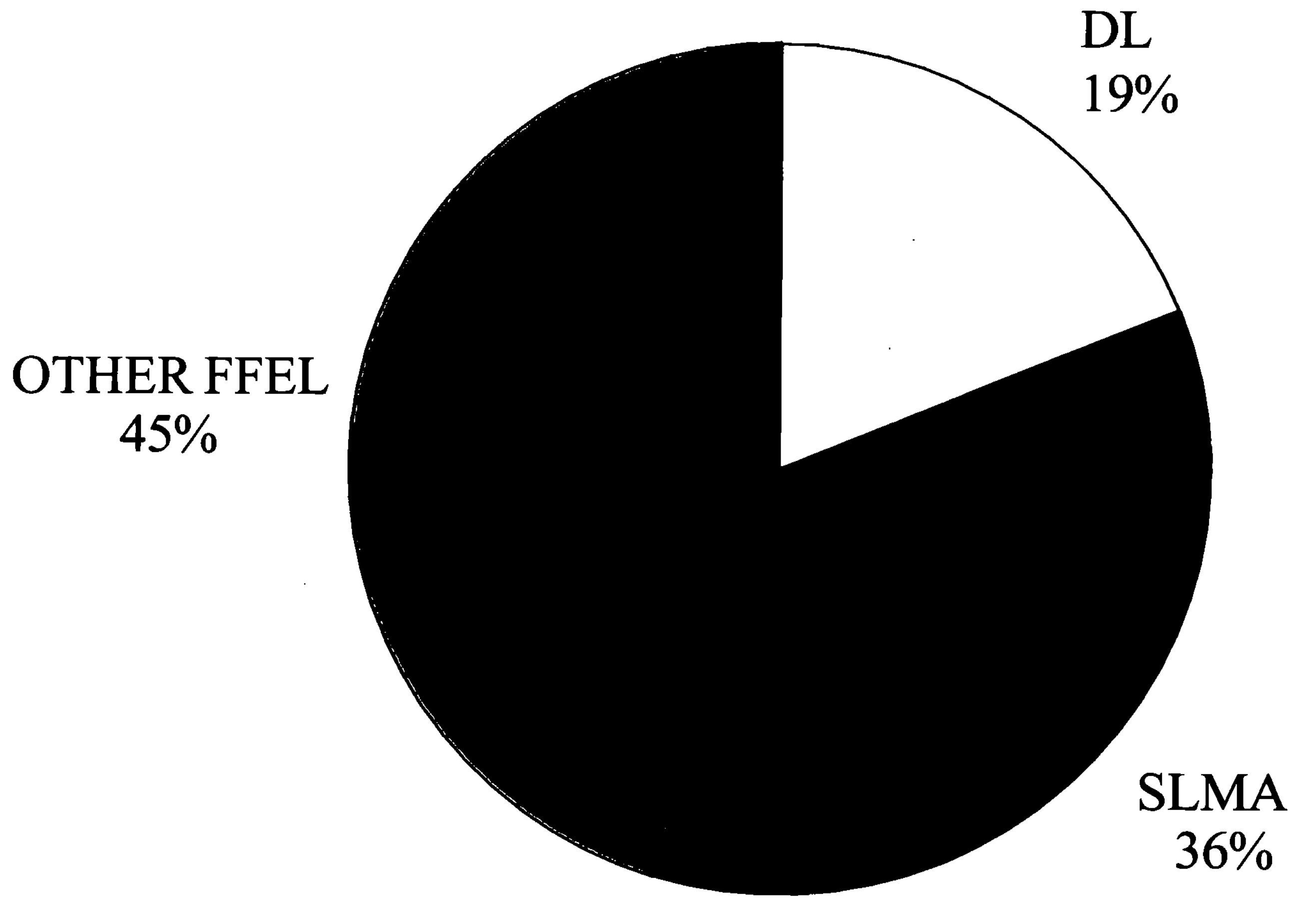

Total = 354,000

## Loan Volume ($)



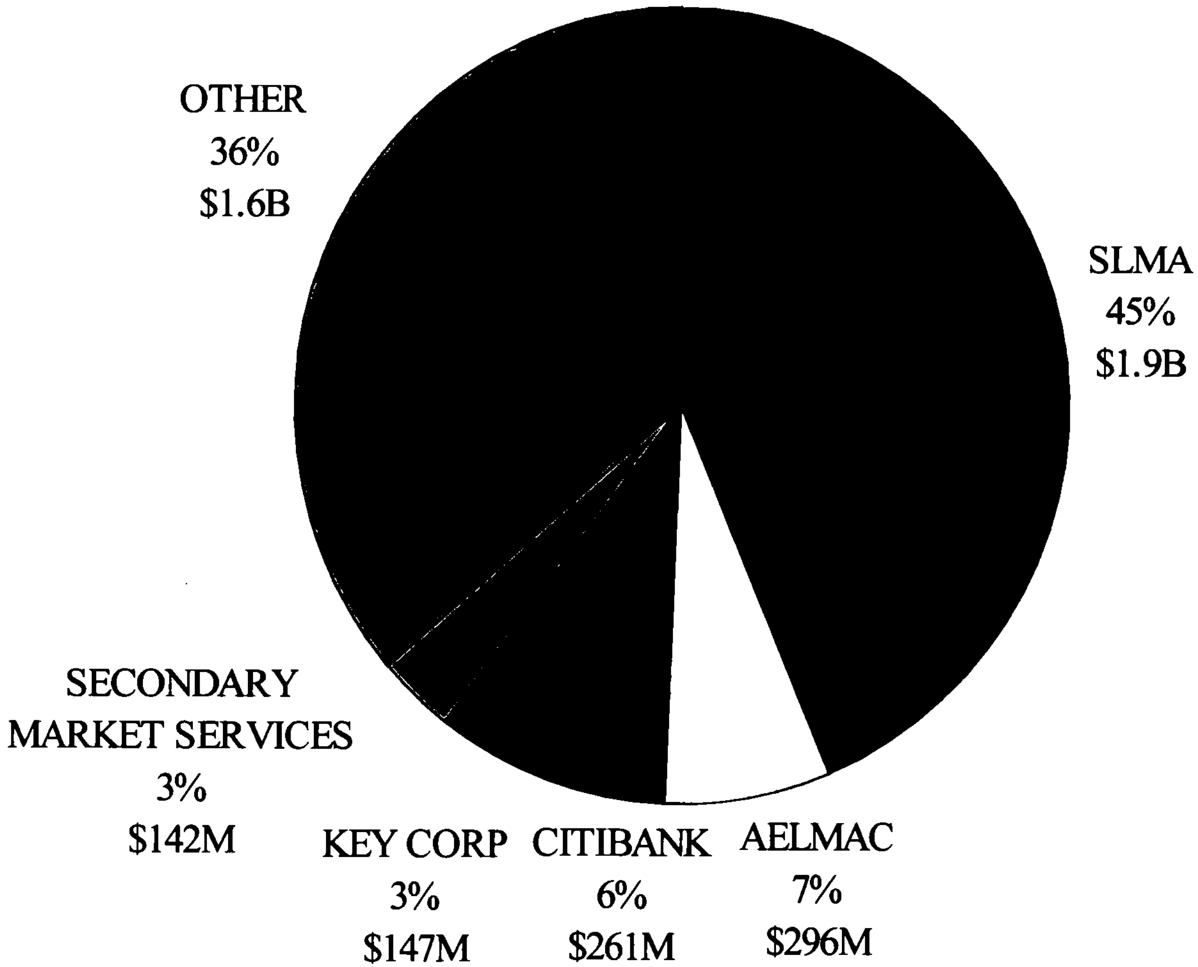

Total = $5.3 Billion

# Consolidation Loan Volume ($)
## FY96




Total = $5.3 Billion

## Distribution of FFEL Consolidation Volume
## Top Lenders, FY96




**Total $4.3 Billion**

Source: GLOS

# Direct Loan Annual and Cumulative Consolidation Volume

| Fiscal Year | Annual Loan Volume | | Average Loan | Cumulative Loan Volume | |
|---|---|---|---|---|---|
| | Borrowers (Thousands) | Dollar (Millions) | Dollars | Borrowers (Thousands) | Dollar (Millions) |
| 1995 | 14 | 333 | 24 | 14 | 333 |
| 1996 | 80 | 1,036 | 13 | 94 | 1,369 |
| 1997 | 66 | 1,080 | 16 | 160 | 2,449 |

Revised 12/1/97

**Note:** Data revised to be consistent with the financial (previous data from CDSI LOC ). I don't think they were properly adjusting for overpayments. Borrower figures for 95&96 were re-estimated based upon previous average loan amounts. 1997 Borrower count from EDS consolidation report (Apps in Funding & Booking Status). Smoothed $5 million adjustment proportionally over all 3 fiscal years. (Currently, we do not know which year the adjustment should be applied.

| Status of Loan Consolidation Applications Received by EDS Prior to September 1997 | | | |
|---|---|---|---|
| **Number of Consolidation Applications** | **9/15/97 data reported in 9/18/97 testimony** | **Through Monday 12/15/97*** | **Progress Since Testimony** |
| **Received** | 142,856 | 142,856 | NA |
| **In Process** | 84,078 | 4,291** | -79,787 |
| Step 1: Seeking complete application if incomplete | 12,844 | 0 | -12,844 |
| Step 2: Obtaining lender information | 34,963 | 0 | -34,963 |
| Step 3: In underwriting process | 13,642 | 0 | -13,642 |
| Step 4: Obtaining signed promissory note from borrower | 22,629 | 975 | -21,654 |
| **Withdrawn/Deactivated** | 5,067 | 40,661** | +35,594 |
| **Completed (Consolidated)** | 53,711 | 97,904 | +44,193 |

- The December 15, 1997 figures indicate EDS is on track; EDS resumed accepting new applications on December 1, 1997. New applications from December 1 onward appear in separate biweekly reports.

- EDS has now reduced the outstanding inventory by 95% since September 15, 1997. The number of consolidated loans has increased 82% since September 15, 1997. The vast majority of the applications currently in process are applications that were reactivated.

- Almost two-thirds of the reactivated applications (6,218 of the 9,534) have already been consolidated and are included in the 97,904 consolidated applications.

* The December 11, 1997 figures do not include any new records created by EDS as part of its quality control process to resolve conflicting information.

** To date, EDS has reactivated 9,534 applications that were previously deactivated. The 9,534 reactivated applications are not included in the 40,661 withdrawn/deactivated applications. The 6,218 reactivated applications that have been consolidated are included in the 97,904 consolidated applications. The remaining 3,316 reactivated applications are being processed and are included in the 4,291 in process applications, but not in Steps 1-4.

U.S. Department of Education
December 18, 1997

| Status of Loan Consolidation Applications Received by EDS Since December 1, 1997 | | |
|---|---|---|
| **Number of Consolidation Applications*** | **Cumulative Through 12/12/97** | **Current Bi-weekly Activity Through 12/12/97** |
| **Accepted** | 903 | 903 |
| **In Process** | 902 | 902 |
| Step 1: Obtaining lender information | 878 | 878 |
| Step 2: In underwriting process | 18 | 18 |
| Step 3: Obtaining signed promissory note from borrower | 6 | 6 |
| Step 4: In ICR Process** | 0 | 0 |
| **Deactivated** | 0 | 0 |
| **Withdrawn** | 1 | 1 |
| **Completed (Consolidated)** | 0 | 0 |

- The Department's contractor, EDS, resumed accepting new consolidation applications on December 1, 1997. EDS expects volume will initially be modest, but will increase substantially after the first of the year.

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

** 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.

U.S. Department of Education
December 17, 1997

**Direct Loan Consolidation Start-Up**
**Talking Points**
**December 2, 1997**

**Did EDS succeed in processing the backlog?**

- Yes. Since September 15, EDS has reduced the backlog by roughly 98 percent, from 84,078 applications to 1,774.

- Of these 1,774 applications, 227 are funded or ready to be funded and should completed in the next few days; 480 are waiting for a signed promissory note; and 1,067 are waiting for IRS processing before they can enter income contingent repayment.

**Isn't EDS's success in eliminating the backlog mostly due to deactivated applications?**

- No. In fact, between September 15 and December 1 (the period during which EDS eliminated the backlog), EDS has consolidated more loans than it deactivated, 43,000 to 35,800. Over half the loans in the backlog were consolidated, while roughly 43 percent were deactivated.

- EDS cannot complete a Direct Loan consolidation if the application does not contain all the necessary information. Consolidation applications were only deactivated after repeated efforts to obtain the information were unsuccessful.

- EDS will promptly re-activate and process a deactivated application upon request of the borrower at any time.

**How many applications does EDS anticipate receiving in the first week of December? In all of December?**

- EDS expects to receive 500 applications in the first week of December and 17,000 applications in all of December.

**How many total applications does EDS anticipate it can handle?**

- EDS can process about 6,000 consolidations each week, although it can accommodate higher short-term peaks. This capacity can be expanded with appropriate lead time.

**How many borrowers applied for loan consolidation between August 27 and December 1? What will happen to them?**

- Between August 27 and November 26 (the latest date for which figures are available), EDS received 33,479 inquiries and applications for direct loan consolidation.

- EDS has stored the address of every borrower who sought a loan consolidation during the temporary suspension. It will mail each of them a letter informing them that it has resumed accepting consolidation applications and offering them a new application.

- In addition, operators at the 1-800-4-FED-AID hotline are informing interested borrowers that the direct loan processing center began accepting consolidation applications December 1 and offering to mail them an application.

**How will the Department ensure that another backlog won't develop?**

- The Department, EDS, and the independent quality control unit, Price Waterhouse, have collaborated to re-design the loan consolidation process. The new procedures have been proven successful: since September 15, EDS has completed over 4,000 consolidations each week -- far more than is typical of any other student lender, including Sallie Mae when it was still consolidating loans.

- Important improvements made to the EDS loan consolidation process include:

  - **Improved data accuracy.** Better data accuracy through more frequent borrower contact and use of the National Student Loan Data System early in the application process;

  - **Managerial controls.** EDS is improving the tracking of applicant information and developing new management reports to assist with system monitoring;

  - **Hiring new staff and adding expertise.** EDS has increased their staff by 20 percent and added experts in financial services and student loan operations; and

  - **Reengineering the loan certification process.** EDS is working with the largest government-guaranteed lenders to improve the speed and accuracy of the process by which the loan holder certifies the loan balances.

- If necessary, EDS customer service representatives will refer applicants to government-guaranteed loan consolidators. The Department has surveyed the largest loan consolidators to determine their capability to provide loan consolidations.

**What impact will the two-way consolidation bill have on the direct loan consolidation program, and how is ED and EDS preparing?**

- Some borrowers who were not previously eligible for a government-guaranteed consolidated loan have been made eligible by the new law. Although Sallie Mae has halted its loan consolidation program, we expect other government-guaranteed lenders -- including Citibank and the Arizona Loan Marketing Association -- to aggressively pursue these borrowers.

- The Department has surveyed the largest government-guaranteed lenders to determine their excess loan consolidation capacity and ensure the smooth implementation of the new law. It is also helping the Direct Loan servicer build the capacity to respond to requests for information from government-guaranteed lenders.

- The Department is co-sponsoring a one-day workshop with the National Council of Higher Education Loan Programs for members of the student loan community to discuss the implications and implementation of the new law. The workshop will take place in Washington, DC in mid-December.

**What will happen to borrowers who otherwise would have had their loans consolidated by Sallie Mae? Can EDS handle the increase in applications?**

- EDS has extra capacity to accommodate additional borrowers. In addition, the Department has surveyed the largest government-guaranteed lenders to determine who has the interest and capability to expand their loan consolidation programs following the Emergency Student Loan Consolidation Act. We believe that we will be able to provide loan consolidations to all borrowers who request them.

**Does the Education Department foresee that the increase volume could have an impact on turn-around time?**

- We do not believe that increased volume will lead to a longer turn-around time.

**Is the Education Department considering bringing on an additional contractor as backup? When will the Department make an assessment of future needs in that regard?**

- The Department is closely monitoring the level of service EDS provides to borrowers and will make an appropriate decision as we move forward in this process.

Direct Loans

# HARVARD UNIVERSITY

**Directors of Financial Aid**

**December 17, 1997**

# Direct Loan Update


Joe L. McCormick
Marge White
Direct Loan Task Force

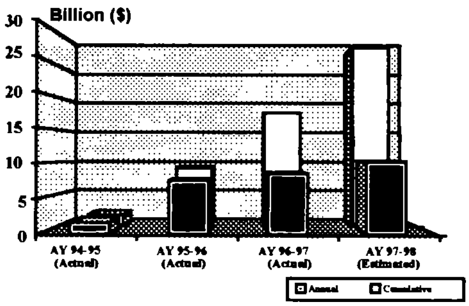

Direct Loans

## *An Impressive First Three Years of Program Delivery*

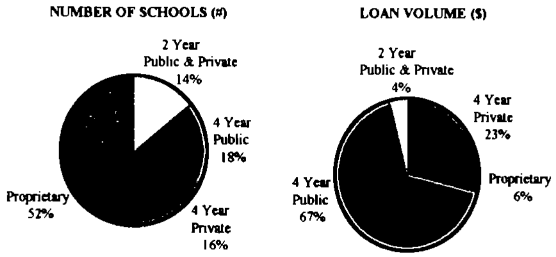
- **1994/95 first year DLP with 104 schools**
- **1996-1997 1,272 DLP schools disbursed $9.7 Billion in student loans**
- **DLP has 32% of total federal student loan volume**
- **Total DLP portfolio is now over $21.0 Billion**
- **# of DLP schools increased 11% in 96/97 over prior year**

Direct Loans

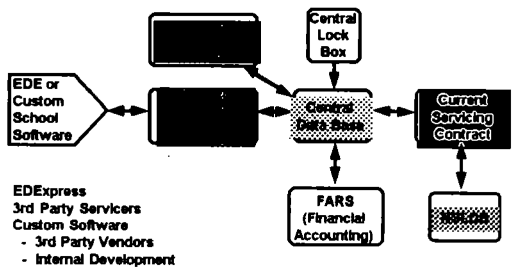
## DLP Loan ($)Volume



## DLP Distribution for Academic Year 1996-97



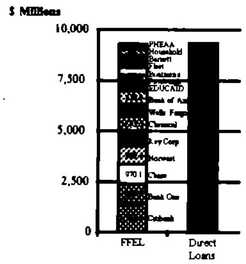

## Direct Loan System Architecture

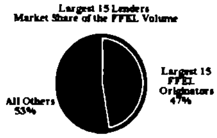



## Loan Origination Center Update

- **5.0 million records transferred from CDSI to EDS March 3, 1997**
- **EDS/Montgomery is a totally new LO System**
- **Fall 98 Processing:**
  - over 2.7 million loan origination records representing $9.5 billion
  - almost 1.8 million p-notes processed with a 0.01% reject
- **98 to 99% of Origination Records acknowledged within the first 24 to 48 hours**

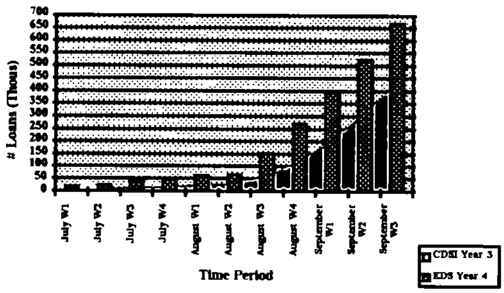
## Largest FFEL Originators in FY 96 Compared to DL




Note $ Based on Gross Committed Amounts

**Number of Loans Processed for Current Academic Year Compared to This Year to Same Period Last Year**

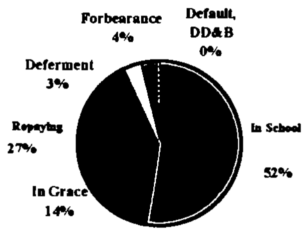



## Direct Loan Servicing Update

- **Multiple Servicer Implementation halted.**
  - *Too costly*
  - *Existing contractor (CDSI/AFSA) to service all Direct Loans.*
  - *Adequate capacity*
  - *Known capabilities*
- **A Single Payment Processing Center**
  *NationsBank of Atlanta, GA is the central lockbox for Direct Loans.*

## Loan Status as of 9/30/97

($Principal Outstanding in Portfolio)




TOTAL PORTFOLIO
$21.3 (B$)

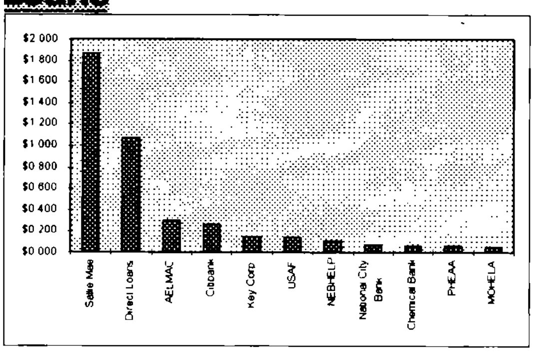
## Direct Loan Consolidation Update

- **August 1997 processing new apps suspended**
- ***December 1 Direct Loan Consolidation began processing new applications***

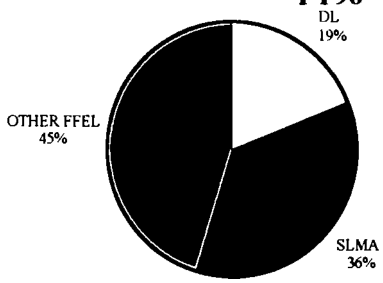
- **As of 12/11/97:**
  - **97,904 apps completed & funded**
  - **4,291 applications now pending**
  - **40,661 deactivated loan apps, of which 9,448 have been reactivated to date**

- **Major improvements to DL Consolidation processing made to insure ED can process future volume**

## FY96 Loan Consolidation Volume

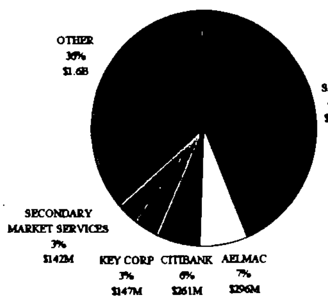


## Consolidation Loan Volume ($) FY96




Total = $5.3 Billion

**Distribution of FFEL Consolidation Volume**
**Top Lenders, FY96**




**Total $4.3 Billion**

Source GLOS

# On the Horizon

- More User Friendly WebSite
- Interactive Budget and Repayment calculators (DONE)
- Web Access to Student Accounts (12-15-97)
- Electronic Bank Debit Loan Payments (February 98)
- Change of Address/Deferment & Forbearance processing via WEB site (May 1998)
- Resource Guide for Direct Loan Schools

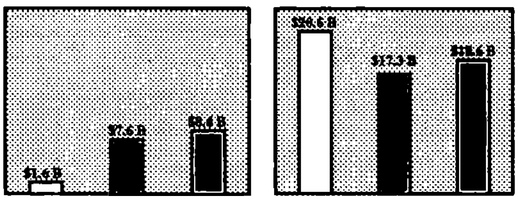
# FFEL and Direct Loan Programs Compared

Selected Portfolio Statistics

9/30/97

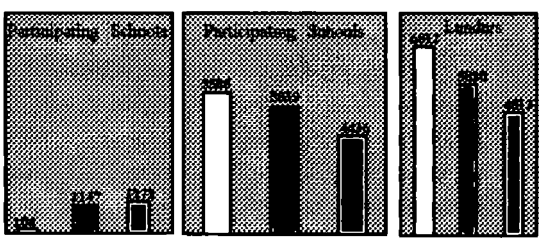
## Federal Student Loan Volume

Direct Loans | FFEL




## Federal Student Loan Program Participants

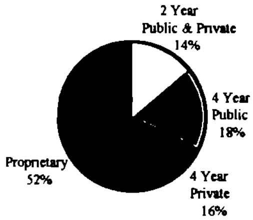
Direct Loans | FFEL



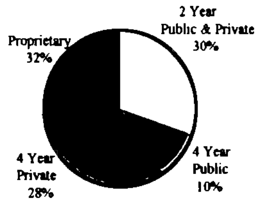
# # Participating Schools by Type/Control

1996-97

Direct Loans



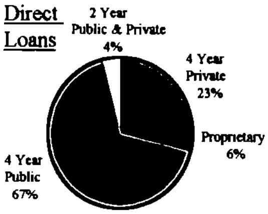

FFEL



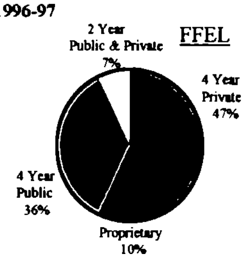

# Participating Schools by Type/Control Total Loan Volume ($)

1996-97

Direct Loans

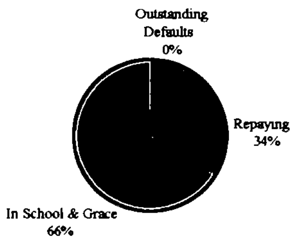



FFEL

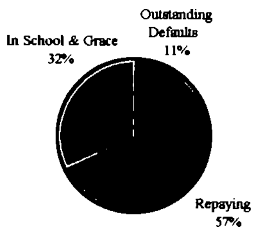



# $ Principal Outstanding in Portfolio

Direct Loans




FFEL



Direct Loans

## Pre - Reauthorization
## Recent Events

- **FY98 Appropriations**
  - $40.0 billion in SFA funds
  - $3,000 maximum Pell award
- **Hope Scholarships/Lifetime Learning Tax Credits**
- **Loan Consolidation Legislation**
  - FFELP can now consolidate Direct Loans
  - Interest rate will be same for both FFELP & DLP
  - Nondiscrimination language added
  - Sallie Mae announced it would not consolidate loans under these new terms

Direct Loans

## Pre - Reauthorization
## Recent Events

**FY95 Cohort Default Rates**

- **Schools final rates November 5, 1997**
- **104 Direct Loan Schools included**
- **National rate - all time low 10 .4 %**
- **Direct Loan national rate 3.8 %**

Direct Loans

## Context for 1998 Reauthorization

- Federal budget will be balanced
- Resources will be limited
- Demand for higher education will increase among traditional & non-traditional populations
- Involves 44 programs in HEA

**Direct Loans**

## Clinton Administration's Higher Education Strategy

Reauthorization Themes
--------
Higher Education Act

- Access: Opportunity with responsibility
- Effective Education: High standards & high achievement
- Simplify program delivery & improve management
- Improve outreach & linkages

**Direct Loans**

## Clinton Administration's Reauthorization Proposal Status

- Department of Education recommendations are in OMB clearance
- ED Reauthorization recommendations may not be announced until the FY99 Budget is submitted to Congress
- Secretary will likely ask for authority to develop a Multi-Year Promissory Note

**Direct Loans**

## Reauthorization Themes: Student Loan Issues

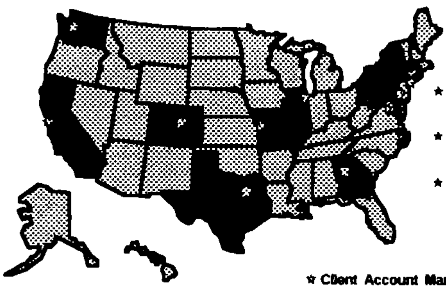
- Loan Fees
- Interest Discounts
- Multi-Year Promissory Note
- Consolidation between FFELP & DLP
- Annual Loan Limits
- Interest Subsidy Calculations
- Role of Guarantee Agencies

## Direct Loan Task Force

- Direct Loan Task Force Chair, Joe L. McCormick
- Direct Loan Task Force Deputy Chair, Marge White
- Program Operations Team
- Loan Consolidation Staff
- Loan Servicing Systems Team
- School Outreach Team
- Regional Client Account Managers in ED Regions
- Dedicated Direct Loan staff in other SFAP Service Areas

**Telephone:**
**(202) 708-9951**

## Direct Loan Client Account Managers



- ★ Customer Service
- ★ Technical Support
- ★ Training

★ Client Account Manager Offices

# Direct Loans

## The New Paradigm in Student Lending

# MEMORANDUM

TO: Marshall S. Smith
Bob Shireman

FROM: David A. Longanecker

DATE: December 3, 1997

SUBJECT: Upcoming Reports on OPE Operations

I thought that you might be interested in the following list of reports on OPE programs tentatively scheduled for December release. These reports are important not only from a management perspective, but also in shaping the public's perception of the effectiveness of OPE management practices. Consequently, I have asked my staff to closely monitor upcoming reports and to prepare responses when appropriate.

In December, we anticipate the possible release of three reports by Macro International, a Departmental contracter; four reports by the Office of the Inspector General; and two by the General Accounting Office. Below, I have summarized the anticipated findings of these reports and indicated where I disagree with those findings.

**The Department's Administration of the Direct Loan program, Macro International**
Macro International was commissioned by ED to assess ED's administration of the Direct Loan program during the 1996-97 academic year. A draft copy of this report is currently being reviewed by the Department. A final draft may be issued later this month. Findings include:

- ED achievements. Noted ED accomplishments include a high level of customer service, enhancements to Direct Loan training and program materials, the reintegration of the Student Financial Assistance offices, and the successful implementation of the Regional Client Account Managers system

- Program growth. The report notes that institutional participation in the Direct Loan program has plateaued; only about 70 new schools signed up for Year 4 of the program. However, the sentence from the draft report that was quoted by the Chronicle of Higher Education -- "This low level of new participation shows that the postsecondary-education community has serious reservations about the viability of the program" -- has been removed from the report.

- Loan Origination. A number of successes are noted, including a smoother process, "very satisfied" financial aid officers overall, and praise for EDS's technologically advanced solution. However, the report concludes that the loan origination also faced difficulties related to the Loan Origination Center (LOC) transition and would benefit from more experienced staff, more reporting, and better customer service by EDS.

- Reconciliation. Reconciliation delays last spring contributed to case study schools' frustration with the new LOC. ED officials noted that problems in this process have been addressed. However, problems with Year 2 and Year 3 records remain, and more consistent data accessibility and reliability are needed.

- Consolidation. The report identifies a number of issues with consolidation, including customer dissatisfaction, poor management of the consolidation process by ED, and data integrity problems.

- Organizational Management. Issues arose concerning OPE's organizational structure, staffing shortages in some areas, and lack of performance measurement in the Direct Loan program.

In our view, the report does not fully reflect progress the Department has made -- perhaps because the report's research was completed several months ago. Our response to the report will include:

- Program growth. Direct Loan program growth slowed for two reasons: the political uncertainity surrounding the future of the program and the improvements in the government-guaranteed program due to competition with Direct Loans. However, the number of participating schools did increase by 11 percent, a significant increase.

- Loan Origination. The loan origination process is now functioning very well. So far this academic year, we've quickly, smoothly, and accurately originated $9.8 billion in student loans. Over the last six months, over 98 percent of all transactions have been acknowledged and processed within 48 hours.

- Loan Consolidation. The Department took decisive action to address these problems. EDS has improved its process, resolved 97.5 percent of the backlog, and resumed accepting new applications on December 1, as planned.

- Reconciliation. The decision to delay reconciliation -- while possibly frustrating for schools -- was the right one, because it maintained program integrity and allowed EDS and the schools time to implement needed system changes. The Macro report does not recognize these management realities.

- Organization management. While it is true that improvement is needed, OPE has already begun the lengthy process of integrating SFA systems. NSLDS is the first step in that long road. OPE is also moving toward performance-based contracting.

**Direct Loan Institution Case Study, Macro**
Macro was commissioned by the Department of Education to study a small number of schools participating in the Direct Loan program during the 1996-97 academic year. A draft report is currently circulating the Department. A final draft will be issued later this month. Findings include:

- A survey of 12 Direct Loan schools during academic year 1996-97 found an overall high level of satisfaction with the Direct Loan program, including loan origination, although the schools expressed frustration with processing delays and transmission difficulties following the transition to the new Loan Origination Center.

- Surveyed schools also made recommendations to the Department, including:
    - Improve the customer service provided to schools by the LOC;
    - Give students more access to their loan information; and
    - Create a Direct Loan policies and procedures manual for financial aid officers and provide on-site technical assistance.

**Direct Loan Institutional Survey, Macro**
Macro was commissioned by the Department of Education to survey all schools participating in the Direct Loan program during the 1996-97 academic year. The Department expects to receive and begin review of a report draft this week. A final draft may be issued later this month. While I have not seen detailed survey results, I expect mixed findings.

**Income-Contingent Repayment, Office of the Inspector General (OIG)**
OIG is examining the impact of the Income Contingent Repayment (ICR) plan on Direct Loan collection process. A draft of the report will be sent to OPE for comment later this month. On October 27, 1997, OIG shared its preliminary findings with OPE staff. Findings include:

- The ICR plan increases the costs to relevant parties:
    - Borrower costs may be increased by capitalized and/or accrued interest and tax liability;
    - Direct Loan program costs are increased through interest subsidy costs, annual income verification, and additional servicing costs; and
    - Taxpayer costs are increased by the portion of the loan that the borrower is unable to pay and the additional cost of capital.

- Other repayment options, such as extended and graduated plans and deferment and forbearance options could adequately accommodate ICR borrowers.

- Improved accounting practices are necessary for the Department to determine the costs of the ICR plan and the composition of and changes in those costs.

We feel that this report is based upon flawed analysis, for the following reasons:

- Even if defaulters do not make their full ICR payment, the available data show that defaulters pay back more of their debt under ICR than they do in the DCS/guaranty agency system.

- The 18.5 percent fee that borrowers must pay to consolidate their loans is also required by the DCS/guaranty agency collection agencies. Further, there are fines and penalties in the DCS/guaranty agency system that are not levied in regular repayment.

- The per-loan costs for servicing for new consolidation loans and income verification is minimal. If a borrower enters into ICR, there is no additional subsidy cost because few borrowers would take a forbearance, which delays the period of their repayment and increases their interest burden.

- Taxpayer costs. Because of interest costs, even those borrowers who do not pay off their entire loan balance are projected to pay nearly 200 percent their original debt.

- The President campaigned on providing borrowers with the option of repaying his or her loan as a percentage income. While this policy may cause pose some obstacles to the government, this Administration has determined that this is a sound social policy worthy of the effort.

**The Department's Oversight of Direct Loan Schools, OIG**
OIG is examining whether the Department's management of Direct Loan schools is adequate. A draft report will be sent to the Department for comment later this month. Expected findings include:

- The Department does not have sufficient data to provide adequate oversight of the Direct Loan program. EDS reports are infrequent, sometimes inaccurate, and not useful. Data is not effectively shared.

- The Department conducts too few program reviews and enforcement actions.

- Four components share responsibility for overseeing Direct Loan schools: IPOS, AFMS, PTAS, and the Direct Loan Task Force. There are few formal lines of communication and coordination between them.

While OPE has not yet received the draft report, I expect that we will disagree with some of its findings. We will respond appropriately.

**Interest Rates on Defaulted Loans, OIG**
OIG is examining whether ED's Debt Collection Service (DCS) is applying the correct interest rate to defaulted loans. The OIG made recommendations for a DCS task order to rectify the interest rates on certain defaulted loans; DCS modified its task order per OIG's recommendations. OIG plans to close this audit and issue an action memorandum later this month. OPE's response will be coordinated by DCS.

**National Student Loan Data System Data Quality, OIG**
OIG is studying whether the data submitted by guaranty agencies for inclusion in the National Student Loan Data System (NSLDS) is accurate and complete. OIG will issue an action memo later this month recommending that ED take action to improve internal controls at guaranty agencies. OPE's response will be coordinated by GLOS and PSS.

**Debt Burden for Postsecondary Students, General Accounting Office (GAO)**
Pursuant to a request from Sen. Carol Mosley-Braun, GAO is studying the impact of the student debt burden. GAO will share the draft report with OPE for possible comment later this month. Expected finding:

- Cumulative student debt level have increased between 1989 and 1996. More students are borrowing and they are borrowing more. The number of students who work is also increasing, but the hours worked per student is not.

**Default Rates at Historically Black Colleges and Universities, GAO**
Historically Black Colleges and Universities (HBCUs) are exempt from the law that excludes colleges with high default rates from participation in federal student loan programs. GAO is studying how HBCU students compare for characteristics linked to loan default to those at other schools and across HBCUs. GAO will share the draft report with OPE for possible comment later this month. Expected finding:

- There is no difference in high default loan student characteristics at HBCUs and other schools.

I hope this information is helpful to you. As I indicated above, my staff and I will continue to track and prepare for upcoming reports.

JK - FYI from Dave -M

# REPORT OF

# THE

# STATE AUDITOR

## HIGHER EDUCATION COST CONTAINMENT

### PERFORMANCE AUDIT
NOVEMBER 1995

The chart shows that all schools have implemented improvements to their financial aid processes and that their solutions have taken a variety of forms. We reviewed Direct Lending at two schools--the University of Colorado at Boulder and Colorado State University--and we discuss our conclusions in the first part of this chapter. We also reviewed Electronic Data Express at two different schools--Colorado School of Mines and Pikes Peak Community College--and we discuss our conclusions in the last part of this chapter.

# Direct Lending Provides Benefits to Students and Schools at Minimal Cost

There are perceptions among some members of the higher education community that Direct Lending is expensive for schools to implement and maintain. Our review of Direct Lending costs at the University of Colorado at Boulder (UCB) and Colorado State University (CSU) concluded that this has not been the case for these campuses. We found:

- **Revenues and savings exceeded implementation and operation costs.** The federal government reimburses UCB and CSU for administering the Direct Lending program. Additionally, both schools have earned interest on federal funds received before the first day of class each fall and spring semester. Since the schools receive a large amount of cash from student loans earlier than they did under FFEL, they do not need to draw state-appropriated funds from the State Treasury until later in the semester. Therefore, the State Treasury earns interest on these funds until schools need them. This is a benefit for the Colorado taxpayer.

- **Direct Lending improves services to students.** Under Direct Lending, financial aid offices have more control over the loan process. Additionally, since the program involves only students, the federal government, and institutions of higher education, financial aid offices know whom to contact to solve most loan problems. UCB and CSU report they can now resolve most loan problems and disburse funds to students within 72 hours. Previously, resolving loan problems could take from four to six weeks.

- **Direct Lending has improved the efficiency of other business processes.** Since implementing Direct Lending, the Bursar's Offices at both UCB and CSU no longer need to sort and file student loan checks. This has reduced staff workloads at the beginning of each semester at each school.

Although we identified benefits from Direct Lending at these schools, we also identified some areas for improvement. Specifically, schools need to improve systems for:

- **Evaluating programs.** Both UCB and CSU need to improve data available for evaluating financial aid programs to measure shifts in workload and identify areas for improvement.

- **Tracking and estimating costs.** Some of the expenditures attributed to the Direct Lending program at CSU were for activities that were not new to Direct Lending but were for activities that also occurred under FFEL. As a result, the financial aid office requested and was authorized to spend new funds for implementing Direct Lending that it did not need.

- **Monitoring federal draw requirements and interest benefits.** CSU did not draw federal funds for Direct Lending proceeds as early as it could have during spring semester of 1995. As a result, we estimate it lost about $27,000 in interest earnings. Institutions have opportunities to maximize interest earnings from funds through good cash management and monitoring practices.

- **Tracking student comments and complaints.** CSU discontinued its processes for tracking student complaints and comments. Student comments are a good source of information on strengths and weaknesses of financial aid programs and can assist with identifying areas for improvement.

# Direct Lending Revenues and Savings Exceed Costs

Our review of revenue and cost information at UCB and CSU revealed that the cost of implementing Direct Lending was significantly less than the revenues and savings generated by the program. To defray the cost of originating loans, the federal government paid schools a Payment of Originating Services (POS) of $10 per borrower. Schools also earned interest from loan proceeds. Schools generated savings by reducing temporary and full-time staff. The following chart compares ongoing and implementation costs with revenue and savings at both UCB and CSU.

| Direct Lending Revenues, Savings, and Costs at UCB and CSU for Fiscal Year 1994-95 | | |
|---|---|---|
| **Revenues** | **Amount Earned** | |
| | UCB | CSU |
| Payment of Originating Services (POS) | $105,770.00 | $ 94,260.00 |
| Interest Earned on Draws | 76,423.00 | 16,344.00 |
| **Total Revenues** | **$182,193.00** | **$110,604.00** |
| **Savings** | **Amount Saved** | |
| 2 FTE Financial Aid Office- CSU | | $51,024.00 |
| 1/2 FTE Financial Aid Office- UCB | $29,924.00 | |
| Temporary Employees Bursar's Office- CSU | | 3,794.00 |
| Mailings | 10,382.00 | |
| Printing | 220.00 | |
| **Total Savings** | **$40,526.00** | **$54,818.00** |
| **Costs[1]** | **Amount Spent** | |
| One-time Costs | $23,209.00 | $31,978.00 |
| Operating Costs | 7,709.00 | |
| **Total Costs** | **$30,918.00** | **$31,978.00** |
| **Total Benefit (Revenues + Savings - Costs)** | **$191,801.00** | **$133,444.00** |

**Source:** State Auditor's Office analysis of information collected from accounting systems at UCB and CSU.
[1]**Note:** Costs include only those costs over and above what schools would have spent under the FFEL program.

The chart shows that after considering implementation and operating costs, UCB and CSU received benefits valued at about $192,000 and $133,000, respectively, from their Direct Lending programs.

## Revenue Earnings May Change

Although schools have earned revenues from Direct Lending, these earnings may decrease in the future for a number of reasons. First, Congress may discontinue the POS payment. However, since schools never received a similar reimbursement under FFEL and the ongoing costs for operating Direct Lending are minimal, schools indicate there will be little hardship if POS payments discontinue. Second, CSU plans to implement Automatic Clearing House (ACH) for student accounts at some point in the future. This will enable schools to deposit loan proceeds directly into student bank accounts. When ACH is fully implemented, CSU will no longer earn interest from the portion of the loan proceeds refunded to students and deposited in their bank accounts. However, CSU and the State Treasury will continue to earn interest on the early influx of cash from loan proceeds that is applied to tuition, fees, housing, and other education-related expenses.

## Direct Lending Has Created Interest Revenue for the State Treasury

**The State Treasury earns interest on state-appropriated funds until schools need them.**

The State of Colorado also benefits from Direct Lending. Direct Lending provides a large influx of funds to UCB and CSU (about $22 million each) several days before school starts each semester. Schools report this figure is growing each year. Although institutions report some of these funds are refunded to students, more than half are retained by the institutions for tuition, fee, and housing payments. This means that schools are receiving some of their tuition, fee, and housing revenue earlier than they did in the past. As a result, schools do not need to draw their state-appropriated funds until later in the semester. This is a benefit to the Colorado taxpayer since the State Treasury earns interest on state-appropriated funds until schools need them.

Neither UCB nor CSU have systems that quantify this benefit effectively. However, our review of draw schedules for fall of 1993 shows that UCB drew 44 percent of its state appropriation by the end of December. In fall of 1994, after implementing Direct Lending, UCB drew only 20 percent of its state appropriation. The changes in the draw schedule at CSU for the same time period were not as dramatic. This is because CSU used a conservative estimate for Direct Lending funds during the first year of implementation. Additionally, the early arrival of federal funds has less impact on its cash flow since it has earlier tuition due dates than UCB and, therefore, earlier influx of cash anyway. CSU has considered the change in cash flow that occurred during the first year of Direct Lending and has adjusted its draw schedule for Fiscal Year 1996 accordingly.

## Direct Lending Provides Better Service to Students

Direct Lending has also improved services to students at both UCB and CSU. For example, Direct Lending has:

- **Eliminated long lines.** Before implementing Direct Lending, schools report that students would wait in line for three to ten hours at the beginning of each semester to receive their loan checks. During fall semester of 1993, 2,466 students waited in line for loan checks at the Coors Event Center at UCB (Students went to the Coors Event Center at the beginning of classes to resolve problems with registration, financial aid, and student accounts.) In fall of 1994 (after implementing Direct Lending) only 237 students went to the Coors Event Center to pick up loan checks. Although quantifiable data were not available, CSU also reported significant reductions in student lines after implementing Direct Lending.

- **Reduced time required to receive loan proceeds.** Under Direct Lending students can generally receive loan proceeds within 72 hours after submitting their loan applications, which is helpful when students need funds for an emergency. Previously, students had to wait four to six weeks.

- **Improved problem resolution.** Schools report that before Direct Lending, most student questions and complaints involved the location of the loan check. Since loans under the Direct Lending program are handled only by institutions and the federal government (through the U.S. Department of Education), it is much easier for schools to identify and resolve problems. Schools report that most loan problems can be resolved within 72 hours.

## Direct Lending Has Improved the Efficiency of Other Business Processes

UCB and CSU reported the following improvements as a result of Direct Lending:

- **Cash Flow.** During fall semester 1994 Direct Lending enabled CSU to disburse almost $16 million to student accounts and provide almost $9 million in student refunds by the first day of classes. In fall 1993 only $2 million had been disbursed and $900,000 refunded by the first day of classes. Similarly, UCB has increased the percentage of bills collected at tuition due dates as a result of Direct Lending, as shown in the following chart.

| Percentage of Outstanding Bills Collected as of the Early, First, and Second Due Dates<br>University of Colorado at Boulder | | | |
|---|---|---|---|
| **Due Date** | **Fall 1993** | **Fall 1994**[1] | **Difference** |
| Early Billing | 37% | 50% | 13% |
| **First Due Date** | 59% | 65% | 6% |
| **Second Due Date** | 94% | 94% | 0% |
| **Due Date** | **Spring 1994** | **Spring 1995** | **Difference** |
| **Early Billing** | 32% | 42% | 10% |
| **First Due Date** | 60% | 68% | 8% |
| **Second Due Date** | 95% | 96% | 1% |

**Source:** University of Colorado at Boulder--Bursar's Office.
**Note:** [1]First Year of Direct Lending.

- **Workload.** Workload at the UCB Coors Event Center decreased by 96 percent in the fall of 1994, and participation by the Bursar's Office at the Center ceased in the spring of 1995. CSU no longer hires temporary employees to handle the workload associated with distributing and cashing paper checks for student loans, saving almost $4,000 in salary costs during fall of 1994.

- **Billing and Receivable System (BRS) Payments.** UCB reports the number of BRS payments to cashiers decreased by 17 percent between fall semester 1993 and 1994. Similarly, payments decreased by 26 percent between spring semester 1994 and 1995. These decreases occurred because Direct Lending funds are disbursed directly to student accounts. CSU reports reductions in volunteers who assisted with processing paper checks for student loans at the beginning of each semester.

# Improve Systems for Evaluating Programs

Both UCB and CSU could improve their systems for evaluating financial aid programs, including Direct Lending. Currently both schools have little information available for this purpose. UCB has developed a few performance benchmarks for its Direct Lending program, but these benchmarks evaluate processes that are beyond the control of the financial aid office and so are not as useful as they could be. At CSU we found that little data exist for measuring or quantifying the efficiencies or outcomes of Direct Lending; instead staff provided anecdotal evidence of program benefits based on their experience. Staff at both schools indicate they would like to improve information evaluating their Direct Lending programs.

## UCB and CSU Need a Framework for Assessing the Benefits of Direct Lending

UCB and CSU need information quantifying the strengths and weaknesses of Direct Lending to make decisions about improvements to the program. For example, information evaluating Direct Lending can be used to measure shifts in current and future workload, determine areas where staff could be reduced, and identify inefficiencies in the loan process.

Without information quantifying the results of Direct Lending, schools cannot demonstrate or report on the advantages of the program adequately. Additionally, schools do not have quantifiable information on which to base decisions to enhance or modify program processes. Both UCB and CSU reported that they intend to review workloads and staff requirements in the coming year. Quantifiable data will ensure that both schools have the necessary information to make these decisions. Additionally, measurable outcome data will provide other information schools need to ensure the continued success of the Direct Lending program and would be useful to other schools in the State who are considering implementing Direct Lending.

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### Recommendation No. 3:

The financial aid offices at Colorado State University and the University of Colorado at Boulder should improve processes for measuring and evaluating the results of Direct Lending and other financial aid programs. Specifically, institutions should:

a. Identify the information that will be essential for resource allocation and management decisions, such as changes in workload, efficiency of processes, student satisfaction, and complaints.

b. Develop appropriate outcome measures.

c. Develop systems to collect data needed to evaluate outcomes.

d. Evaluate the data against outcome measures and use the information for resource allocation and management decisions.

### Colorado State University Response:

Agree. The University agrees that appropriate outcome measurements would provide a valuable tool for evaluating the efforts of the financial aid office.

### University of Colorado at Boulder Response:

Agree. We will enhance our data collection that is essential to resource allocation and management decisions such as processing time for different tasks, quantity of phone calls, and assessing peak processing time in different departments.

We will assess work flow and processes in the financial aid office, so appropriate costs can be attributed to different projects and programs, and identify benchmarks that can be used to measure new processes.

We will enhance our current data collection methods and systems, so data can be easily collected and retrieved in a manner meaningful for measurements and comparisons. We will survey our customers to determine customer satisfaction with new programs and our service in general. We have already begun to implement better data collection such as: document processing time, number of and reasons for promissory note rejections by the processor, application processing time, and verification processing time. This data will be evaluated to determine resources needed at peak processing times and improve processes to eliminate errors.

For new projects, desired outcomes will be incorporated into the planning process and assessed at appropriate stages.

## Improve Internal Systems for Tracking Costs

We found CSU did not have good information on what it cost to implement Direct Lending. We identified the following problems with the cost information:

- **Implementation Costs.** Actual expenditures presented to the Executive Budget Committee in April of 1995 included about $33,000 in costs for Direct Lending that the financial aid office would have incurred under the former FFEL program. In other words, these costs were not new costs.

# Getting the Third Degree

**BUREAUCRATIC BUMBLING. ANTIQUATED COMPUTER SYSTEMS GONE WILD. MISPLACED PAPERWORK. THUGGISH COLLECTION AGENCIES. JUST ANOTHER DAY IN THE STUDENT-LOAN BUSINESS.**

By Devin Leonard

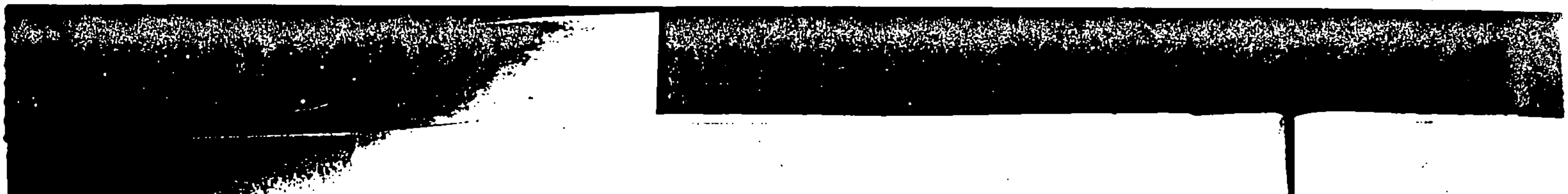
**IT BEGINS SIMPLY ENOUGH, AS MOST NIGHTMARES DO.** You go off to college, financed in part by your summer jobs, your parents' savings and—as a final resort—some low-interest college loans guaranteed by the government. The amount of that borrowing may be small—in 1993 the average undergrad borrowed about $3,300 a year to get through college—or it may be huge, like the $69,000 many medical-school students have to take out in loans. But like millions of people before you, you fill out the forms, try to keep track of how much you owe and then—once you've finished your degree—start the laborious process of paying the government back.

And that's where the nightmare kicks in. Small things start to go wrong. A letter explaining you've gone on to graduate school—thereby granting you a deferral on your payments—gets lost in the bureaucratic maw of the loan industry. Perhaps your bank's computer system mysteriously starts rejecting your electronic payments. Or maybe your address is entered incorrectly and your lender can't track you down. Suddenly, the industry has a name for you, a name you'll find hard to shake for what may seem like an eternity, a name that could haunt you every time you try to get a mortgage or even a credit card.

*Deadbeat.*

Far-fetched? Far from it. Just ask David Anderholm. In 1993, Anderholm, a fourth-year psychiatric resident, thought he'd squared everything away before moving to Scottsdale, Ariz., for a two-month stint at the city's Mayo Clinic. He and his wife, Julie, arranged for neighbors to water the plants at their Rochester, Minn., home and

**PHOTOGRAPHS BY DANIEL BORRIS**



[illegible] the dog at his brother's [illegible], Anderholm had taken [illegible] care with his student loans, which were being handled by EduServ Technologies, a Minnesota loan servicer. Anderholm, 30, didn't have to start paying back his loans until he finished his medical education. But once a year, he had to send forms reminding EduServ that he was still a medical student. Lately, he'd been having trouble with the company, which kept telling him it hadn't received his letters.

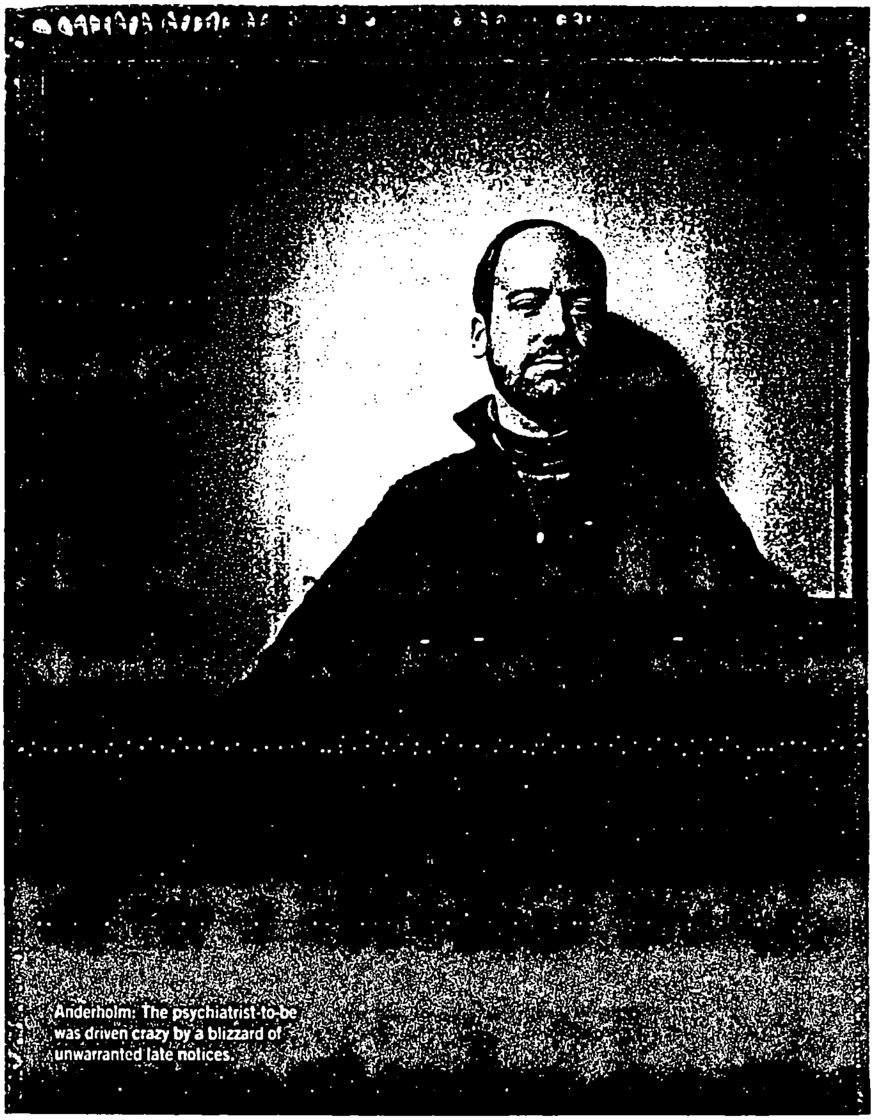
Then, just three days after arriving in Scottsdale, Anderholm found two letters concerning his student loans in a bundle of forwarded mail.

"Oh, no," he thought, ripping open the first envelope. "This isn't good."

It sure wasn't. The first letter was a warning from EduServ that he was about to default on a $2,300 loan. In the second, Northstar Guarantee, the Minnesota agency that handles delinquent student loans, threatened to turn him over to a collection agency if he didn't pay up—at once.

Anderholm immediately called EduServ, where an apologetic supervisor told him not to worry. "Uh, sorry," she said sheepishly. "We're having computer problems. Just ignore those letters. Everything's under control."

If only it were. Instead of stopping, the flow of threatening notices from EduServ and Northstar increased—to as often as every other day. As EduServ later admitted, Anderholm was only one of thousands of perfectly innocent loanholders who were blitzed with unwarranted late notices because the company's computer couldn't seem to process their loan-deferral requests. "We had this brand-new computer system, and we needed to get the bugs out to get it to work properly," concedes Shirley Chase, an EduServ senior vice president. "It was not a fun time period for us."



Anderholm: The psychiatrist-to-be was driven crazy by a blizzard of unwarranted late notices.

But that explanation came too late for Anderholm, who, after months of being browbeaten by EduServ representatives, decided to dip into his meager savings account and pay off the total $6,844 in loans EduServ was processing. Unfortunately, that meant he didn't have the cash to pay off his Visa bill for several months. But Anderholm didn't care. "It was worth it for my mental health," he says.

The usual stories about student loans involve deadbeat graduates and fly-by-night trade schools, all out to bilk the system. (In fact, the government—to great fanfare—recently announced that it had cut the default rate on student loans over the past few years through such measures as stepping up prosecutions of deadbeats, attaching the wages of more defaulters and using a computerized system to block loans to ineligible students.) But there's an untold story of the student-loan business, and it involves people like Dave Anderholm, who have every intention of paying back the money they've borrowed to finance their educations but get caught up in a maelstrom of bureaucratic bumbling, computer systems gone wild, misplaced paperwork and even thuggish collection agencies. It's a tale of borrowers—and there are thousands of them—who've had their lives disrupted or even been put in default because of a mistake made by their loan servicer or guaranty agency.

"It's just become part of the experience of getting a student loan," says Ivan Frishberg, a lobbyist for the U.S. Public Interest Research Group, a nonpartisan advocacy group representing 500,000 students. "There's a snafu or confusion somewhere, and the student goes into default. Then when you try to get anybody to listen to you.

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fault. Then when you try to get it worked out, it's almost impossible to get anybody to listen to you."

Franz Kafka couldn't have dreamed up a more Byzantine and consumer-unfriendly bureaucracy than the one that oversees guaranteed student loans. According to a 1995 report by the College Board, banks dole out $22.9 billion worth of federally guaranteed student loans a year. More often than not, students have no idea what happens to their loans once they've received their checks from the bank. But about 70 percent of these loans are sold to one of the 90 secondary-market companies that invest in this debt. And if you think that could create a little confusion, consider this: If a student borrows money four years in a row for her undergraduate education, each loan can be treated as a separate account—and sold to four different secondary marketers.

Bruce Caplin, director of operations for RC Services, a collection agency on Mercer Island, Wash., has run across doctors and lawyers with as many as 30 different loans. "You know, when you are going through school, you're just signing papers all the time," Caplin says. "I deal with people all the time who just don't know which way is up."

But wait: It gets worse. Most lenders and secondary agencies hire an outside loan-processor to service their accounts, adding yet another layer to this bureaucratic maze. Now let's say there's a problem. Your deferral paperwork gets lost. Or perhaps your loan processor's computer is acting up. Unless you can find a sympathetic supervisor to straighten out your problem—and don't count on that—your loan will be sold to one of the 41 guaranty agencies that reimburse banks for bad loans.

You sigh with relief, right? Many of these are state-run agencies—working for you, really—and they'll surely help straighten out the mess. Besides, all guarantors are supposed to make sure lenders have followed the correct collection procedures before they asked to be reimbursed for bad loans. Trouble is, your guarantor actually has a financial incentive to rubber-stamp the lender's decision and rule that your loan is in default. The federal government not only reimburses these agencies for 98 percent of every defaulted loan, but Congress in its wisdom also gave them the right to keep an additional 27 percent of whatever they collect from defaulted borrowers.

Small wonder the General Accounting Office worried in a 1993 report that these "financial incentives . . . result in guaranty agencies placing emphasis on collection of defaulted loan balances rather than on the prevention of defaults." That's exactly what concerns many college officials. "The guarantors do better if there are defaults and don't do as well if they don't get defaults," adds Barmak Nassirian, a policy analyst at the American Association of State Colleges and Universities in Washington, D.C. "I'm not accusing these companies of intentionally tripping up kids. But let's face it—you are what you eat."

Not surprisingly, guaranty agencies get pretty indignant when anybody suggests they aren't doing their damnedest to prevent defaults. "It's just utter nonsense," insists Mark Cannon, executive director of the Coalition for Student Loan Reform, the rather ironically titled trade group of guarantors. "To cure a delinquent loan prior to going into default is the goal of every guarantor. Defaults are ugly for everyone—the school, the student, the guarantors. They should be avoided."

Maybe so. But of late, the student-loan guaranty industry hasn't exactly set a record of rectitude and good management. For example:

- In 1990, the government was forced to close down the nonprofit Higher Education Assistance Foundation in Minnesota, then the nation's largest student-loan guarantor, because the agency was unable to make good on $9 billion in loans it had insured. Congressional critics charged that HEAF's problems were brought on because it indiscriminately guaranteed even the worst trade-school loans—many of which were serviced by a for-profit company owned by HEAF's founder.
- In 1993, Virginia's State Education Assistance Authority was slapped with a $26 million fine by the U.S. Department of Education for failing to process loan payments on time, billing the feds for the wrong amounts on defaulted loans and sinking its money into risky investments. The SEAA is appealing that decision and declines to comment.
- The following year, the executive director of the California Student Aid Commission resigned under pressure after the Department of Education ordered the agency to repay $62 million it had received to cover defaulted loans. Many of the problems cited were blamed on the CSAC's new $14 million computer system. In fact, the feds recommended junking the entire system because it was unable to provide accurate student-loan information. The CSAC is fighting the action in court.
- Last year, the Pennsylvania Higher Education Assistance Agency deluged an estimated *18,000* borrowers with late notices that were completely unjustified—all because it was putting in a new computer system. Rattled borrowers say that when they called to set the record straight, PHEAA didn't own up to the computer snafu and instead treated them like deadbeats. PHEAA says it's still working on the problem.

With horror stories like these, it's not surprising that some people think the guaranteed-student-loan program is beyond repair. Says Nassirian: "Rube Goldberg couldn't have come up with a better sketch of a screwed-up system than what we have here."

**'Just ignore those letters,' AN EDUSERV SUPERVISOR TOLD DAVID ANDERHOLM. 'EVERYTHING'S UNDER CONTROL.' IN FACT, THE AGENCY'S NEW COMPUTER SYSTEM WAS RUNNING AMOK AND ANDERHOLM WAS ONE OF THOUSANDS CAUGHT IN ITS TRAP.**

In 1992, when Shari Clair enrolled at San Francisco's New College of California law school, she was already heavily in debt. In nine years, she'd borrowed $24,978 in student loans, much of which had gone to pay her undergraduate tuition at the University of Southern California. After the first semester of school she realized that her finances looked a little shaky. So she decided to go to school part time and increase the hours she was working as a paralegal.

That's when her problems really started.

Going part time meant she had to change her status with AFSA Data, the Utica, N.Y., loan processor servicing eight of her loans. Rather than being automatically deferred, Clair had to ask for forbearance on her loans—she had to fill out eight separate forbearance requests and refile them every semester.

Not surprisingly, the system soon screwed up. In July 1993, Clair was rejected when she applied for a credit card. Why? AFSA had listed one of her supposedly forborne loans as seriously delinquent. When she contacted the loan processor, it said she hadn't filed a forbearance form for that loan in February. Quickly, things went from bad to worse: AFSA turned her loan over to the California Student Aid Commission, and the CSAC quickly put her into default. In September, the New College's financial-aid office told her she was no longer eligible for student loans.

Clair finally turned to the San Francisco Neighborhood Legal Assistance Foundation for help. It got AFSA to turn over repayment records showing it had received, but apparently never *processed,* the February 1993 forbearance request. Elated, attorney Elizabeth Imholz asked the U.S. Department of Education to make the CSAC review the case. "I thought they would read the facts and say, 'Wow! This slipped through the cracks,'" she says. Imholz clearly hadn't read her Kafka: In May 1994, the CSAC responded that AFSA actually had received the form, but it was for the wrong loan! In other words, though Clair wasn't a deadbeat and had repeatedly filed forms for her eight loans, the CSAC had put her through hell over a technicality.

Imholz made a personal appeal to Becky Stilling, the CSAC's deputy director. Without admitting it had acted incorrectly, the CSAC arranged to remove Clair's loan from the default list and get it repurchased by Sallie Mae, the nation's largest purchaser of student loans. Clair took out a $6,000 loan from Bank of America and paid off three semesters of tuition bills just weeks before she finished her studies in December 1994. Both AFSA and the CSAC say they can't discuss the case of an individual borrower.

Drained after a year and a half of fighting the CSAC while simultaneously attending law classes and working as a paralegal, Clair flunked the bar exam two months later. To make matters worse, she's started getting dunning notices again. When the CSAC put her into default in 1993, all her other loans automatically came due. Once again, Clair had to seek forbearances—and now AFSA has told her she's used up all her forbearance time. With more than $50,000 due, Clair wishes she'd never gone to law school. "I borrowed all this money," she laments, "and I have nothing to show for it."

If Clair's story is about fumbled paperwork and bureaucratic stonewalling, Steve Fought's is one of almost unbelievable pettiness: A four-month-long fight over whether or not Fought had correctly entered the last digit of his identification number.

It all started early last year, when the Department of Education announced that frazzled borrowers could consolidate their multiple debts into one easily managed loan under the federal direct-lending program. This was a threat to the guaranty agencies, which often have affiliated secondary-market companies with their own consolidation plans. Consolidating through the guarantors was not as attractive as going through the feds: Often borrowers had to pay higher interest rates. And in some cases, they lost the right to have their interest subsidized if they went back to school. Worse, in some states, their interest could be capitalized.

No wonder borrowers preferred the federal program. Or that, according to Leo Kornfeld, the Department of Education's assistant secretary for student financial affairs, more than a few guaranty agencies did everything they could to make it tough for borrowers to consolidate with the feds. "They've slowed it down," he says. "They are resisting it. Some more than others, of course, but do you know why? They are losing money. They are losing that shot at that 27 percent collection fee."

In January 1995, Fought, a 41-year-old congressional aide who lives in Arlington, Va., tried to transfer $12,000 worth of law-school loans being serviced by the Pennsylvania Higher Education Assistance Agency to the federal consolidation plan. An unrepentant penny pincher, Fought actually pays his utility bills two at a time so he can save money on stamps. Consolidating with the feds would lower his interest rate to 8.25 percent from 8.45 percent, and Fought wanted in—quickly.

But PHEAA wasn't in any hurry to let him go: It took two months for it to tell Fought that his loans couldn't be transferred because the account number on a key form was wrong. (Of course, the agency took only three days to inform him of its own consolidation plan.)

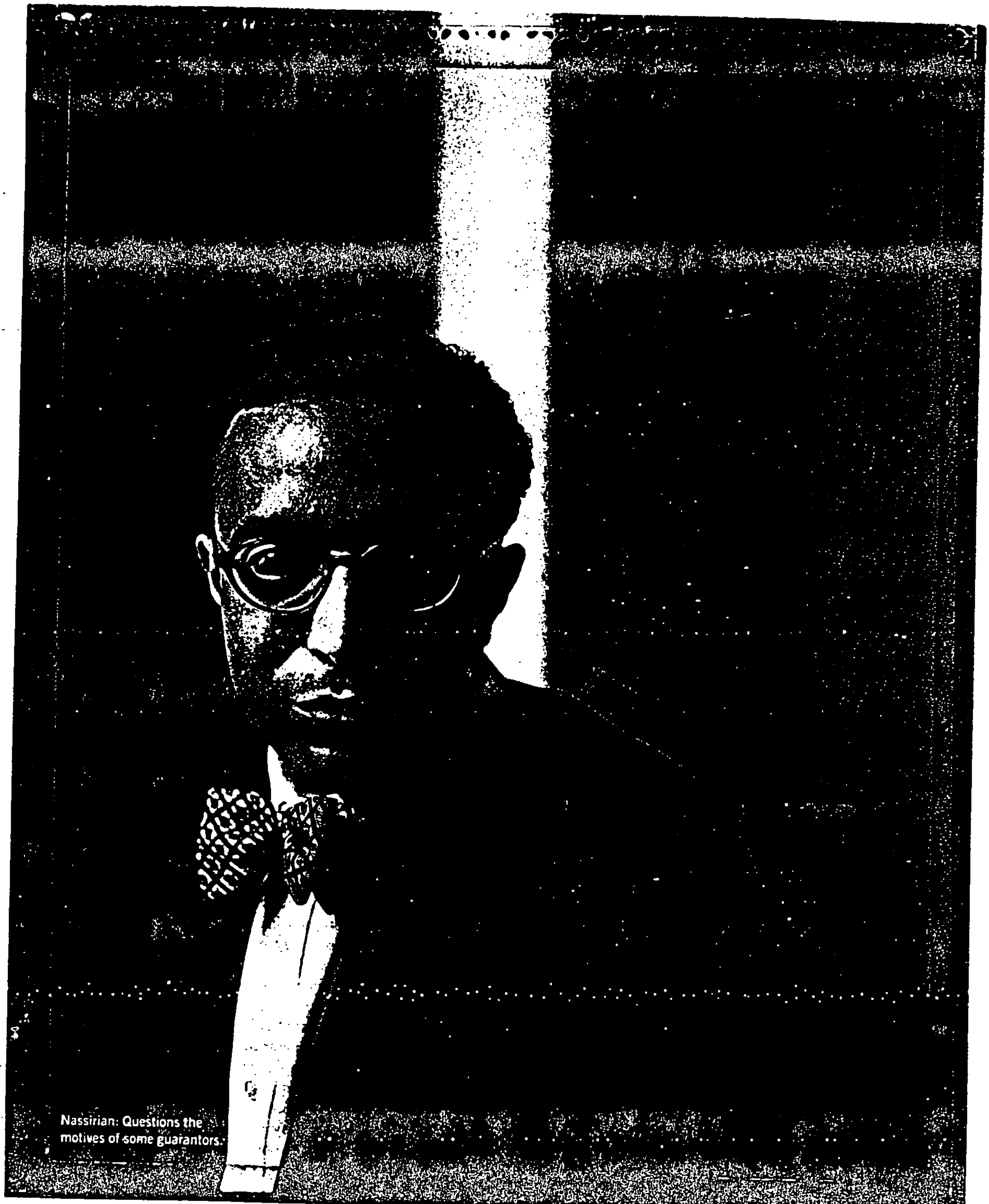
PHEAA's account numbers were simple, nothing more than a borrower's Social Security number followed by a letter or number. In Fought's case, the letter was I. PHEAA claimed Fought had written the numeral 1. Fought found it strange that in almost three years of loan payments PHEAA had always managed to cash his checks, but PHEAA insisted that this time he'd made a mistake. And it took Fought another two months and countless phone calls before his loans were released. "It was a battle over basis points," he says, still irked about those four months spent at a higher interest rate. "I wanted to save some money."

When Colette Matzzie tried to consolidate her PHEAA loans, she was desperately strapped for cash: Matzzie, 29, was then making $35,000 a year clerking for a federal judge and, with eight loans totaling $82,000 from her years at Brown University and Georgetown law school, she faced $1,200 a month in loan payments. She wanted to go into the federal direct-loan program, which has an income contingency plan that lets borrowers pay a percentage of their adjusted gross income.

In March 1995, three months after she'd contacted PHEAA about her plans, Matzzie was amazed to learn the Department of Education had just gotten her paperwork from PHEAA—and it was blank. Matzzie was beside herself with anger. Because she'd expected her consolidation to sail through without a hitch, she'd held off on sending her latest payment to PHEAA. Now one of her loans was past due.

When Matzzie called PHEAA about the mix-up, she learned that not only was the agency not taking responsibility for the screw-up, but it also had reported her to the major credit bureaus. "Sorry," a PHEAA-crat told Matzzie, "our computer does it automatically." Matzzie used her Visa card to make the payment. And eventually her consolidation went through. But not before she made dozens of calls to PHEAA. Amazingly, during these conversations, one agency rep suggested Matzzie could save herself some aggravation if she just left her loans in place.

Some people think THE STUDENT-LOAN SYSTEM IS BEYOND REPAIR. 'RUBE GOLDBERG COULDN'T HAVE COME UP WITH A BETTER SKETCH OF A SCREWED-UP SYSTEM THAN WHAT WE HAVE HERE,' SAYS POLICY ANALYST BARMAK NASSIRIAN.



Nassirian: Questions the motives of some guarantors.

# Loan Warfare

## DOING BATTLE WHEN THE DEFAULT'S NOT YOURS

PHEAA spokeswoman Susan Grimm doesn't know what happened to Matzzie's forms, but she adamantly denies the guarantor played games with anybody's paperwork to hold on to its loans. "There are cases where these forms have gone back to the borrower because they must be exact," Grimm insists. "They have to be signed. They have to have the correct account number. Those are the federal regulations."

**Guaranty agencies** are supposed to make sure that proper procedures are followed before borrowers are put into default. But, critics charge, they don't seem to *try* very hard. Under federal law they have to make five attempts, generally phone calls or letters, to get you to pay up. Unfortunately, there's no law requiring them to actually reach you. So if your guarantor has an out-of-date phone number or the wrong address, you're out of luck. If there's no response after 180 days, it's official: You're a deadbeat. And soon, there's going to be a collection agent on your heels.

That's not pleasant. Just ask Kimberly Kuhn, a nursing-home coordinator in Las Vegas. One night in November 1993, Kuhn came home from work and found a "final notice" from Account Control Technology, a Glendale, Calif., collection agency, in the mail. It warned that if Kuhn didn't immediately pay the $1,100 balance on the $5,000 loan she'd taken out eight years earlier to pay for business courses, ACT [illegible] going to haul her into court. Kuhn never disputed that she owed the mo[illegible] ey, although she hadn't heard from her lender or the guaranty agenc[illegible] three years. But there was no way the Kuhns, with three children, co[illegible] come up with $1,100 (plus $532 in interest and collection fees) overn[illegible] They'd recently borrowed money to have their air-conditioning sy[illegible] fixed. And they had their monthly mortgage payment to make.

The next day Kuhn called ACT and offered to pay in install[illegible] No deal, said the collection agency. Pay it all—now. Kuhn was at [illegible] for what to do next. She tried to put the bill on her credit card, but [illegible] maxed out. Her migraines intensified. And ACT wouldn't le[illegible] alone. One day, a collection agent who identified himself as Pe[illegible] ickson called Kuhn at work and warned her she "would be sued [illegible] weeks" if she didn't pay the entire bill. A few days later, he agai[illegible] her office and ordered her to open her phone book to the finan[illegible] tion and find someone who'd give her a loan to pay the collection[illegible]

The Kuhns took out another mortgage to pay ACT. The d[illegible] planned to send the company a check by certified mail, Ericks[illegible] called her at work and screamed at her. "Go to the post offic[illegible] and send it by Express Mail!" he yelled. She hung up and ru[illegible] the office to mail the check. When she returned, she was horri[illegible] that Erickson had called back repeatedly, berating her co-workers and telling her supervisor that she was a student-loan deadbeat who'd been hired under false pretenses and should be fired.

That, finally, was too much for Kuhn: She got a lawyer and sued. In October 1994, a federal judge ruled that ACT had harassed her and engaged in deceptive debt-collection practices. According to Kuhn's lawyer, Mitchell Gliner, ACT quickly agreed to settle, for an undisclosed amount. ACT refuses to comment on the lawsuit or the settlement.

**With problems** like these, it's not surprising that the U.S. Department of Education wants to give colleges and students other options. At the urging of the Clinton administration, Congress approved an alternative: the Federal Direct Loan Program. Under this plan, colleges and universities can lend federal dollars directly to students. Collection is handled by private loan servicers who are hired by the federal government and get nothing if a borrower defaults. "They lose money if a person goes into default," says the Department of Education's Leo Kornfeld. "The only way they make money is if they keep someone in repayment. Otherwise, we take the paper away from them and give it to one of our collection agencies."

About 37 percent of the new student-loan volume has gone through the direct-loan program and, according to a survey by *Education Daily*, more than 90 percent of participating schools give direct lending high marks. "Whip me, handcuff me," says Karen Fooks, director of student financial affairs at the University of Florida. "We won't go back unless they kill the program."

Because of the direct-loan program's success, guarantors' business is starting to dwindle. In the past two years, guarantors in seven jurisdictions have closed. And there are more to come. Perhaps because of the pressure, some agencies have done better lately. According to the Department of Education, the number of delinquent loans pulled back from default increased 14 percent in fiscal 1995.

But even the threat of extinction hasn't been enough to inspire some guarantors to improve their services. Last summer, the University of Colorado at Boulder's financial-aid office reviewed the records of its students placed in default by, among others, the Colorado Student Loan Program, and was shocked to find students and alumni who were declared deadbeats before they were scheduled to make *their first loan payment.*

And the Department of Education still hasn't figured out what to do with the CSAC's flawed computer system, which has generated blizzards of improper late notices and reams of erroneous default data. "Even after six months of working with them, I'm still not sure what's going on," says a clearly frustrated Kornfeld. "They are telling me Susie Jones is in default. The school says, 'That's wrong—Susie Jones is still in school.' California's a disaster."

Dana Callihan, the CSAC's spokesman, winces when asked about the computer problems, and even admits the system has been so unreliable that the commission—which currently handles $14.9 billion in loans—has gone back to processing some loan payments by hand.

That sounds pretty antiquated, but California's guaranty agency is not the only one stuck in the past. Last year, the problem-plagued PHEAA computer system flipped out when a large number of borrowers began making their payments electronically. The computer couldn't keep up with the inflow of digital cash, which didn't keep it from spewing out unwarranted late notices.

One of the unlucky recipients was Kent Frese, a 31-year-old Villanova University graduate who lives in New Cumberland, Pa. An information-systems manager for a pension company, Frese could forgive the computer problem. But what really galled him was the people hiding behind the technology. "I'd call and sit on hold for 20 minutes," recalls Frese, who waged a five-month war with the agency. "Then I'd get some guy whose attitude was, 'You're just another deadbeat. Pay up.'"

Finally, Frese told the agency he had a statement from his electronic-checking company, which clearly showed that PHEAA's computers were rejecting his payments. Only then did the agency believe him.

Still, it looks as though the guaranty agencies will be around for a while. After ferocious lobbying by banks, secondary marketers and guaranty agencies, Congress approved a 1996 federal budget measure rolling back direct lending to only 10 percent of the loan volume, a move that would cripple the program. President Clinton—who wanted to see direct lending at every school in the country—is putting up a fight: One of the reasons he vetoed the budget-reconciliation bill is that it cut back direct lending. It's unclear what will happen in the final budget resolution, but no one thinks the guaranty agencies are going away soon.

That's not exactly a comforting thought to people like Kent Frese. "You know, I read a lot about all these sleazy people who don't pay their student loans," he says. "I just feel like there's the need for some equal time here. When it comes right down to it, these student-loan collection people are a bunch of bullies."

Author: Joyce Rice at WDCA09
Date: 3/16/98 1:08 PM
Priority: Normal
TO: James Kvaal at WDCA08
Subject: counters for response to Student lending, Soviet Style
------------------------------------ Message Contents ------------------------------------

What a whiner! I am surprised that Investors Business Daily, a supposedly reputable magazine would publish a letter to the editor that does not substantiate its claims. My biggest concern is the scare tactics---the letter leads the reader to believe that the stats are the result of a survey and that schools are bolting from the program left and right. Also, much of the other information is not entirely true. These are my counters for what they're worth --

Banks in the FFEL program have lent their capitaL because of MUCH SUPPORT FROM THE GOVERNMENT -- Under the FFEL program the government makes interest payments to lenders on students behalf while they are in school and during deferment and grace periods. Interest subsidies (special allowances) are also paid to lenders by the government for the life of a loan to ensure a competitive rate of return for the use of the lender's loan capital.

Interest rate cuts have no relationship to program administration -- The interest rate reduction is part of an overall plan to help ease the burden of borrowing and make attending college more affordable and subsequently expand access to a college education to a wider audience--something the student loan industry should support.

Direct Loan schools have NOT complained about too much red tape -- In fact direct lending schools usually cite administration as one of the most positive aspects of the program--because there is less paperwork and only one lender rather than multiple lenders to deal with. ED's IG, GAO or MACRO International, the three organizations responsible for evaluating the Direct Loan program, have never mentioned that schools have complained about too much red tape in any of the many surveys conducted of the program. That's absolutely not true. A MACRO International study released in 1995 which compared various aspects of loan "program administration" between the Direct Loan and FFEL Program, found that Direct Loan schools consistently gave the program higher satisfaction ratings than did FFELP schools. In the most recent Case Study (1996-97 page 16-17) conducted by MACRO schools commented that having to deal with only one servicer as compared to multiple servicers under the FFEL program, made their interactions much less time-consuming. If you want to include a specific quote or two from schools about program admin look below --

"I am a strong advocate of direct lending because it has simplified the process of providing loans to students considerably. It has simplified the administrative process and makes compliance much easier" (Paul Aasen, Director Financial Aid, Gustavus Adolphus College, St. Peter, MN October 1997)

"The speed, simplicity and efficiency that direct lending affords the Office of Financial Aid has had direct and positive impact on the recruitment and retention of students on our campus" (Phil Shreves, Director of Financial Aid, Central Missouri State University January, 1998)

"..we have more problems with FFELP loans and virtually no problems with Direct Loans. Going Direct did not increase our work load nor has it put a burden on our resources" (Magaret Robinson, Director of Financial Aid, Southwestern College, Winfield, KS January 1998)

"One of the strengths of the Direct Loan processing is institutional control and the absence of multi-players." (Mariko Gomez, Director of Student Financial Aid, Southwest Texas State University October 1997)

Net number of schools has NOT dropped 20 percent nor are more and more colleges opting out -- This just is not true. In fact, approximately 70 new schools have applied to participate since the beginning of fiscal year 1998 even with such negative one-sided reporting and the constant attack from private lenders. Since the program's inception only 18 schools have left the program while nearly 1300 schools have left the FFEL program to join direct lending. To paraphrase the last sentence in the letter -- If it were a contest for accurate reporting between government and private sector the government would win every time.

James Kvaal

see p 5

Joe

Author: Diane Rogers at WDCA01
Date: 4/2/98 4:53 PM
Priority: Normal
TO: James Kvaal at WDCA08
Subject: FW: Service
------------------------------------ Message Contents ------------------------------------

file this one away for future testimonial

Di

Forward Header

Subject: FW: Service
Author: Joe McCormick at WDCA04
Date: 3/25/98 8:29 PM

FYI

Forward Header

Subject: FW: Service
Author: MSUSLOC1.DVIGNA01@eds.com at Internet
Date: 3/24/98 4:42 PM

I want to thank each of you for the work you have put in to making this CAM and the Direct Loan Program a success. As you can see, it takes team work to make it all come together.

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From: LOMAIL
Sent: Tuesday, March 24, 1998 2:41 PM
To: Rushing, Curtis; Vigna, Dwight; Rivera, Edwin; Moyer, Mary Beth; Camp, Steve
Cc: Scott, Kimberly; Nichols, Misti; WIllis, Thelma
Subject: FW: Service

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From: Wood Mason[SMTP:Wood_Mason@ed.gov]
Sent: Tuesday, March 24, 1998 2:31 PM
To: Loan_Origination@mail.eds.com
Subject: Service

To Whomever Sees This,

I want to commend the assistance and attention I have received from
3
of your employees. Over the past several weeks, I have had 3 or 4 "ornery" problems with a couple of my schools, and they have been attentive, professional, and effective.

Thelma Willis, Misty Nichols, and Mary Beth Moyer have all 3 been conscientious to the nth degree in addressing my questions, concerns, and pleas for help. All three have been delligent in keeping me informed on progress, particularly Thelma, as she is continuing work on a couple outstanding issues. All three have been professional in their dealings with me and my schools.

Kudos to Mary Beth, Thelma, and Misty. Please make sure that this e-mail gets to the people that need to know they have, in my book, three "aces."

Author: Diane Rogers at WDCA01
Date: 4/3/98 3:30 PM
Priority: Normal
TO: Debbie Brown at WDCA08
TO: Anne Byrd
CC: James Kvaal at WDCA08
Subject: Re: FW: Weekly Recycle File, XE and Data Correction Status
---------------------------------- Message Contents ----------------------------------

Can any information here be generated into some good news bites for Greg Woods/Shireman?

Di

______________________________ Reply Separator ______________________________
Subject: FW: Weekly Recycle File, XE and Data Correction Status
Author: Anne Byrd at WDCA01
Date: 4/2/98 9:59 AM

The attached great news on the consolidation front. Enjoy! AB

______________________________ Forward Header ______________________________
Subject: FW: Weekly Recycle File, XE and Data Correction Status
Author: "Anderson; Barbara H" <barbara.anderson@eds.com> at Internet
Date: 4/2/98 7:57 AM

> This week's status report demonstrates solid progress being made in all
> areas. The data correction team is on schedule or ahead of schedule in
> most categories. Some new categories of data correction have been noted
> and will be added to the schedule as appropriate. EDS, CDSI and the
> Department are working together to resolve issues, and many are being
> resolved each week. The schedule reflects several open issues where EDS
> is currently awaiting Depratment or CDSI responses.
>
> In communications with CDSI (Nora Hansel) this week, EDS has been told
> that the number of transactions that are hitting the Recycle File since
> the CDSI revisions is so small (currently 10) that CDSI will coordinate
> the corrections with EDS and resolve them on their end. The expectation
> is that there will be no more recycle files coming to EDS. As a result,
> EDS is recommending, and has tentative agreement from the COTR, that no
> further time be spent in developing a reporting capability for recycle
> file performance metrics. The Recycle File transactions which currently
> remain are predominantly dependent on other transaction resolutions before
> proceeding.
>
> The XE report shows that there has been a dramatic increase in the number
> of XEs since the CDSI release. Approximately a dozen issues have been
> reported to CDSI on LO and LC combined, five of which pertain to LC.
> These issues have been documented in a spreadsheet and will be forwarded
> under separate cover. EDS is analyzing and correcting the highest-volume
> transaction error types as the highest priorities at this time. In spite
> of the high volumes of XEs EDS has been receiving, the number of XEs

> outstanding have decreased dramatically since last week, and is expected
> to continue to drop as the analysis on the various transaction types is
> performed and resolutions are determined.
>
> <<ST0330>> <<DCPLAN2.XLS>> <<Xe_prf13>>
> <<RECYPLN3.XLS>>
>