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Direct Loan Program Administration

1993-1998

1999

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1993-1998

Submitted to

Planning and Evaluation Service
Office of the Under Secretary
U.S. Department of Education

Submitted by

MACRO
INTERNATIONAL INC.

1999

This report was prepared under the U.S. Department of Education, Contract Number EA93085001. The views expressed in this report do not necessarily reflect the position or policy of the Department, and no official endorsement by the Department should be inferred.

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ACKNOWLEDGMENTS

This retrospective analysis of Direct Loan Program administration benefited greatly from the willingness of those committed to improving financial aid for students to share their knowledge and experiences. We appreciate the time and thoughts offered by those we interviewed over several months in the spring of 1998.

We would like to thank Steven Zwillinger, of the Planning and Evaluation Service in the Office of the Under Secretary of the U.S. Department of Education, for his support and thoughtful review. Dan Goldenberg also assisted in developing this document by providing comments on an initial draft. The views expressed in this report, however, are those of the Macro evaluation team.

EXECUTIVE SUMMARY

As part of the evaluation of the William D. Ford Federal Direct Loan Program, Macro International Inc. conducted a retrospective assessment of the way U.S. Department of Education (ED) has been administrating the Direct Loan Program since its inception in 1993. The study was designed to assess 1) the extent to which the Department has efficiently and effectively managed the program and delivered high-quality service to its customers, and 2) the extent to which the Department has organized and streamlined its administrative processes and method of service delivery. This review takes place at the end of academic year 1997-98, at a time when four cohorts of institutions are participating in the Direct Loan Program. This report is being submitted at a dynamic period in which a Performance-Based Organization (PBO) is expected to be put in place to manage the Office of Student Financial Assistance Programs. That expectation has prompted a good deal of internal reflection on how ED is performing and has fostered discussions of change and reorganization.

The report employs a conceptual framework that examines key areas of Direct Lending from the viewpoint of internal and external stakeholders. We consider three perspectives:

- The student borrower—the customer for whom Direct Loans were specifically designed
- The institutions—the customer that has primary contact with ED administration
- The Department of Education as its own customer—its priority management areas are reflected in the Strategic Plan and Annual Performance Plan developed over the last year.

The Department's performance from the various perspectives was documented by means of a comprehensive range of sources. We used information from schools and student borrowers collected through surveys and case studies we have undertaken during our evaluation. Our background information was drawn from periodicals and journals; documents from ED, other governmental agencies, and the higher education community; hearings in the U.S. House and Senate; and observations from conferences and training sessions. Interviews with staff at the Department of Education and other groups overseeing the Direct Loan Program provided critical data and insight. In-depth, confidential interviews with more than 50 individuals enabled Macro senior staff to explore current issues and to probe key events and concerns that are a part of the 5-year history of the program.

Most observers, both supporters and critics, acknowledge what a major accomplishment it was to have put the Direct Loan Program into operation in such a short period of time. Direct Lending has emphasized simplicity, flexibility, and customer service—goals that have been met, at least from the standpoint of borrowers and schools. The operation of an alternative loan program has also induced the Federal Family Educational Loan (FFEL) Program to provide innovations that have improved service. The Direct Loan Program has become the largest originator of student loans in the nation ($11 billion in 1997-98) and has acquired a loan portfolio of about $30 billion, making it the second-largest "bank," in terms of student loans. Reauthorization of the Higher Education Act is proceeding with support for both of the student loan programs, in an acknowledgment of the value of competition, institutional choice, and the satisfaction expressed by schools in both programs.

From the students' perspective, seamless loan delivery has for the most part been realized. In Macro's most recent survey of student borrowers, 91 percent of those who borrowed through Direct Lending reported that their experience was easy. (The comparable percentage for FFEL was 87 percent, not a statistically significant difference.) Direct Loan borrowers were also satisfied with the timeliness of receiving their funds, with 89 percent saying that they received their funds in a timely manner. That finding reflects a significant increase from the survey we conducted two years ago (when 85 percent reported having timely receipt of their funds); for FFEL, the comparable statistic was 83 percent in each survey. Not surprisingly, the overall level of satisfaction of students with their loan program was extremely high—96 percent of Direct Loan borrowers were satisfied with their loan experience in the last academic year.

From the institutional perspective, data from Macro's earlier surveys of schools showed a decline in overall satisfaction with the Direct Loan Program, from a high of 89 percent in the first year to a low of 64 percent in the third year of operation. In the survey of institutions we recently completed, satisfaction with the Direct Loan Program had rebounded somewhat in the fourth year, with 71 percent of schools reporting having been satisfied. The pattern for FFEL schools has shown an increase in satisfaction each year, beginning with 68 percent expressing satisfaction in the first year of Direct Lending to 84 percent in the current year. In descriptions of their loan programs, two characteristics of the Direct Loan Program stood out: the flexibility of loan repayment options beneficial to borrowers (cited by 97%) and the use of advanced technology (cited by 89%). Although not discussed in the executive summary, this report gives details of schools' assessments of the ease of program administration, the software, the materials and training that ED has provided, as well as communication with ED servicers and Client Account Managers in Regional Offices.

From the Departmental perspective, we identified several significant constraints for ED by examining the key objectives set forth in its strategic plan to deliver a streamlined, customer-focused loan program. We noted that the Direct Loan Program operates in an environment in which political considerations and budgetary limitations have a powerful influence. The Direct Loan Program came to fruition in a politically charged climate, with opposition from the existing student loan industry, and following the Congressional elections of 1994, even stronger Congressional scrutiny. In recent years the program has felt the impact of tight budgets. Even more significantly, it has faced the need to deliver services on the basis of appropriations rather than fee-for-service, which means that increasing participation produces strains on a fixed sum of money.

Those interviewed from ED and from outside the agency pointed to additional constraints that may be found government-wide: dealing with contracting regulations and being bound by personnel policies. Although common inhibitors in many executive agencies, both issues are seen to have had a direct negative impact on the operation of the Direct Loan Program. Many individuals stressed that the requirements not only create obstacles to providing proper incentives and but also diminish staff and contractor performance. They expressed hope that a PBO would be given the authority to supersede these strictures.

Additionally, the administration of the Direct Loan Program is hindered by several problems pertaining specifically to ED: the current organizational structure, problems of systems integration, and lack of accountability. Reintegrating the Direct Loan Task Force and diffusion of responsibility has damaged decisionmaking and efficiency. Separate stovepipe systems that support Direct Lending and the high cost of maintaining them constitute a major issue that ED continues to confront. Many at the Department lament the fragmentation of accountability and the focus on reactive (rather than proactive) measures.

Through three case studies developed from interviews with participants and observers, this report attempts to derive lessons that can be learned from several significant problems that ED has faced. The cases involve the Loan Origination Center transition, multiple servicer contracts, and loan consolidation.

Finally, we consider issues that the Department has dealt with to make the program more responsive to its customers and to improve its integrity. During the five years of the Direct Loan Program, ED has focused attention on program improvements. We review developments in the areas of training, reconciliation, software, multi-year promissory notes, the Year 2000 project, the National Student Loan Data System, and the Student Status Confirmation Report process.

The Department of Education, the Office of Student Financial Assistance Programs, and the Direct Loan Program are poised for change. Many within and outside the Department view the PBO as an effective management structure that can improve operations from the perspective of the various stakeholders in the Direct Loan Program. Significant challenges for ED have emerged from our analysis of documents about the program and our in-depth discussions with staff. We found that ED officials and staff are optimistic about the future but realistic about the challenges and eager for leadership to take them on.

CHAPTER I. INTRODUCTION

As part of the evaluation of the William D. Ford Federal Direct Loan Program, Macro International Inc. (Macro) has conducted an assessment of the Department of Education's administration of Direct Lending. Commissioned by the U.S. Department of Education (ED), the evaluation examines the overall effectiveness of the Direct Loan Program in terms of simplified administration and customer satisfaction. In addition to the assessment that is the subject of this report, other evaluation components include institutional and borrower surveys and case studies of institutions.

The specific objectives of this report are to:

1. Assess to what extent the Department has efficiently and effectively managed the Direct Loan Program and delivered high-quality service to its customers

2. Assess to what extent the Department has organized and streamlined its administrative processes and method of service delivery.

This assessment takes place at the end of academic year 1997-98. Four cohorts of institutions have entered the Direct Loan Program, and the Program and this evaluation are completing five years of operations. This report captures both current issues and looks retrospectively at some of the important events and issues that have emerged over the course of the program's implementation.

Background

With the Omnibus Budget Reconciliation Act of 1993, the Federal Government created a new loan program, the William D. Ford Federal Direct Loan (Direct Loan) Program. The Direct Loan Program differs from the Federal Family Education Loan (FFEL) Program in that the Federal Government provides the loan principal for student and parent (PLUS) loans; private lenders are not involved. Under Direct Lending, the school certifies a student's (or parent's) eligibility for the loan, and the Department of Education sends the amount requested to the school, which then disburses the proceeds to the borrower.

The Direct Loan Program has been operating since the 1994-95 academic year. At present, approximately 1,350 schools administer Direct Loans, and Direct Lending accounts for about one-third of total Stafford and PLUS annual loan volume, with FFEL making up the remaining two-thirds.

Principal differences between the two programs include:

- The source of capital for Direct Loans is Federal borrowing on long-term Treasury notes; the FFEL Program operates with privately-provided capital through some 4,800 lenders.

- Direct Lending does not utilize guaranty agencies as intermediaries, as does FFEL; thus, there are no administrative allowance payments to these agencies and no reinsurance payments on defaulted loans.

- Under Direct Lending, borrowers' loan applications are processed by postsecondary educational institutions and companies hired under contract by ED; in FFEL, the financial aid package is prepared by the institution, borrowers apply to a lender, and the loan is guaranteed by a guaranty agency.

- Direct Lending offers borrowers flexible repayment options, including graduated and extended repayment schedules, as well as income contingent repayment. The Higher Education Act encourages, but does not require, FFEL lenders to offer such flexible options to their student loan borrowers.

Methodology

A comprehensive set of sources was tapped to view the Department from the student, institutional, and internal perspectives. Macro has collected information from schools and student borrowers through surveys and case studies. These contribute to understanding the Department's administration as a whole and help frame the questions explored through other data sources.

A wealth of information was gathered from interviews with staff and officials at the Department of Education as well as other entities that are partners and observers of the administration of the Direct Loan Program. The interviews were conducted during the months of May and June 1998 by two senior project team members using a protocol of key topics to be covered. Therefore, the information collected represents a snapshot of departmental attitudes and beliefs circa spring 1998. For this report, 44 separate interviews with about 50 individuals in all enabled us to explore current issues related to the Department's administration as well as provide a retrospective look at successes and problem areas during the five years of the program's existence. Those interviewed include high-level officials, senior and middle managers, and staff who are responsible for daily operations and service delivery.

The interviews were conducted with a commitment to protect the confidentiality of those to whom we spoke. Hence, there is no list of those interviewed, but we wish to convey our appreciation for their willingness to discuss the policies and operations of the program and to provide their unique perspectives on its administration. To further protect their confidentiality, we have been careful in this report to describe key incidents or events in terms general enough to avoid identifying any particular individual or individuals, but specific enough to illustrate the key thematic concern.

Other sources supplied context and verification to the information acquired directly through our surveys and interviews. These include a review of documents accumulated during the course of this project, with special emphasis on the past year. We consulted newspaper and journal articles, bulletins and memos from ED and the higher education community, testimony and hearings at the U.S. House and Senate, reports from other government agencies, and documents that were given to us in the course of the interviews. Our appreciation of contemporary program issues were enhanced by attendance at a variety of conferences and training sessions. Finally, members of our Project

Advisory Workgroup, representing both the FFEL and Direct Loan Programs, who have worked with Macro on an annual basis since the inception of this evaluation, were exceedingly helpful in discussing plans for this component.

This Report

This report employs a conceptual framework that examines key areas of the Direct Loan Program from the perspective of stakeholders (internal and external). We first consider the student borrower, who has a limited but important interaction with the Department. It is to improve service for this customer that Direct Loans were specifically designed. Next, we consider the schools' perspective. As the primary interface between the Departmental administration and the recipients, institutions interact with ED for a variety of purposes and through variety of media, and are in a good position to assess how well the Department meets their needs and standards.

Finally, we look at the Department of Education as a customer of itself. The Department has developed an outline of its own priority areas in the management of the delivery of student aid through its Strategic Plan and Annual Performance Plan. Basically the Department has provided a roadmap of areas for assessment and improvement. We are using that framework to review past experience and the current status of the Department's performance in these critical areas as they affect the Direct Loan Program.

Although this report was originally drafted when the Reauthorization of the Higher Education Act was being considered in Congress, the Higher Education Act has since passed, calling for the creation of a Performance Based Organization (PBO) that will provide a management structure to deliver student financial assistance. As a result, this report has been targeted at the new chief operating officer of the PBO, primarily to provide an overview of events surrounding the administration of the Direct Loan Program.

CHAPTER II. ACCOMPLISHMENTS

Staff in the Department, as well as close observers in other agencies and in higher education associations, consistently point to major accomplishments of the Direct Loan Program in its four years of operation. For some, it is the quantitative achievement that is most impressive—the volume of loans that have been processed. The Direct Loan Program has become the largest originator of Stafford loans ($11 billion in originations in 1997-98). It has acquired a student loan portfolio balance of about $30 billion, the second-largest "holder of loans" after Sallie Mae (which has a volume of about $40 billion).

Some of the original goals of the program—simplicity, flexibility, and customer service—appear to have been met, according to feedback from borrowers and schools. In particular, observers point to how well student borrowers have been served by having the choice of four flexible repayment plans, in addition to faster and more reliable delivery of funds. For schools, less paperwork and a streamlined delivery system are the legacy that others laud.

As Higher Education Amendment Reauthorization proceedings have noted, there are two distinct financial aid programs. In the Stafford and PLUS programs, Direct Lending now claims one-third of the share of the total student loan market, with FFEL constituting the other two-thirds. Schools appear to be happy with the program they are in.

Additional accomplishments of Direct Lending often cited are the impetus the program has given to technology use and ease of service delivery—specifically, electronic loan processing for schools and promotion of electronic and Web-based application forms for students, and other helpful aids to students over the Internet. These changes in the way of doing business have positioned the Department to take advantage of other technology advances to better serve students. (Vice President Gore's "Access America" smart cards for students is a prime example.)

Many observers reflect on the size and complexity of what has been achieved in one of the largest U.S. Government-run benefits programs. Others focus more on the impact in the financial aid world. Virtually no one disputes that the operation of an alternative loan program has produced a competition that inspired innovation and service—to the benefit of all borrowers and schools. "All sorts of people doing things that they never would have thought of doing," is how one observer put it. Schools also cite major improvements to the FFEL Program since the implementation of the Direct Loan Program. Some examples are initiatives to simplify processing and expedite delivery for participating institutions, a Common Manual to apply consistent policies, new products provided by guaranty agencies, borrower incentives for repayment, discounts on origination fees, enhanced entrance and exit counseling, and an income-sensitive repayment option.

The Direct Loan Program started with a number of basic objectives: to be customer-focused, streamlined, accountable, flexible, and cost-effective. The Department emphasizes that these objectives have been met. Customer service, in particular, has been a hallmark of the program. Those within the Department (and others) point out the goals may not have been realized to the extent that they would have liked, but they take pride in having gotten a program of this magnitude off the ground. The program continues to be innovative. For example, electronic debit accounts, multiyear promissory notes, and a Web-based FAFSA all represent recent improvements in service to borrowers.

The rate at which schools joined the program has been uneven. Some people have commented on how uneven participation levels have made ED's job more difficult. By legislative mandate, the program started with slightly over one hundred schools in the first year, and some observers thought that it was a small number of schools on which to gear up the automated processing and management systems needed to fully operationalize the program. Then the program experienced a great increase in the subsequent years (especially 1995-96) that at times stretched the capacity of the Department and its contractors. The number of schools entering the program in the later period, Year 4 (actual) and Year 5 (expected), has leveled off at approximately 70-80 per year. Most observers see the current status as one of equilibrium between the two loan programs, where competition works well and institutional choice is operationalized.

Many in the Department stress the need for balance in assessing Direct Lending's performance, emphasizing how far loan delivery service has come. Some feel there is a tendency to concentrate on what is wrong, rather than the streamlined delivery system that has been developed. Macro's annual reports have credited the Department with producing a process that gets loans to students and supports institutions in that effort. However, many outside observers point to the inevitable problems that occur with an undertaking of this size. Despite their concerns, the Direct Loan Program continues to deliver funds in a timely, efficient manner and has proven to be highly adaptable and responsive to the problems that have occurred over the past few years.

CHAPTER III. STUDENT PERSPECTIVE

In the course of Macro's evaluation of the Direct Loan Program, student borrowers have been surveyed three times to determine their experience with borrowing through both Direct Loan and FFEL Programs. They were asked about their overall loan experience, and specifically about the ease and timeliness of receiving funds. They also rated their satisfaction with contacts with their financial aid office for entrance/exit counseling and other services and with the Department of Education. Finally, we have measured borrower awareness of key terms, features, and responsibilities of their respective loan programs. This information gives us a portrait of the Department's efficiency in delivery of loans and attention to customer service from the perspective of its most direct customer.

Macro first surveyed students about their 1994-95 academic year loan experience, a period when some students found themselves in transition from one loan program to another. The second survey involved both Direct Loan and FFEL borrowers in the 1996-97 academic year. The last survey is still underway and focuses on students in repayment. Results of that study will be available in the fall of 1998. It is primarily the survey of 2,000 borrowers about their 1996-97 loan experience that we will use in this report to address the assessment of the Department's performance in administering a program that seeks to put service to students in the forefront.

Receiving Loans

Ease and speed in obtaining a loan are paramount goals of the Direct Loan Program. Reports from student borrowers confirm that these goals are being met.

Site visits to schools and surveys of institutions have repeatedly pointed out that schools switched to the Direct Loan program to improve services for students. Administrators generally report that students find applying for and receiving a loan has become a simple process. The survey findings provide confirmation directly from the student. In our 1996-97 survey, 42 percent of Direct Loan borrowers said that obtaining a loan was very easy. By way of comparison, 35 percent of FFEL borrowers found the process to be very easy.

In all, 91 percent of students borrowing through Direct Lending reported that their experience was easy—very easy or somewhat easy. (The comparable percentage for FFEL was 87 percent—not a statistically significant difference.) These results hold across the board for students in two- or four-year, private or public, or proprietary schools. Satisfaction was virtually unchanged (up 1 percentage point), compared to the survey two years earlier. The seamless loan delivery process has, for the most part, been realized by the student.

The second key issue from the student perspective is that of speed. Direct Loan borrowers indicated that they had received their loans in a timely manner—with 89 percent in this survey describing receipt of their funds as timely. Students' satisfaction with timely loan funding from the Direct Loan Program increased significantly from the previous survey (up from 85 percent). The results for FFEL borrowers remained constant over the two surveys—each time 83 percent of borrowers indicated that they had timely receipt of their funds.

Although these results are a desired outcome of the Direct Loan Program, a more meaningful finding comes from the analysis of students across type and control of institution. Looking at students in two-year, four-year (both private and public), and proprietary schools, a consistent percentage report they have received their loan funds in a timely manner (ranging from 88 to 90 percent). This is a significant accomplishment and indicates that the Direct Loan Program succeeds in its guarantee of loan fund distribution in 24 to 72 hours. In contrast, students in the FFEL program reported great variability in accessing their funds across school types. At four-year public schools, only 76 percent of FFEL borrowers found their loans to be delivered in a timely manner, and at four-year private schools only a slightly higher percent (82%) reported timely delivery. The percentages were considerably higher for two-year institutions and proprietary schools. As there are no uniform time guidelines in FFELP, variability in experience was found. These differences were again seen in satisfaction among FFEL borrowers in large schools compared to small (83% versus 89%, respectively, were said to be timely). For Direct Loan borrowers, the results were identical for both small and large schools—87 percent. Besides providing loans on a timely basis to students, the survey shows that Direct Lending has been consistent in its performance.

Not surprisingly, the overall level of satisfaction of students with their loan program was extremely high. Ninety-six percent of Direct Loan borrowers and 93 percent of FFEL borrowers were satisfied with their loan experience in the last academic year.

Counseling

Although counseling is ultimately the responsibility of the financial aid offices, both loan programs have encouraged and supported with counseling materials these services to students. Overall, students were much happier with both exit and entrance counseling in the last academic year than they had been in 1994-95. In the most recent survey, students in the Direct Loan Program reported greater satisfaction with both entrance and exit counseling by the Financial Aid Office: 90 percent were satisfied with entrance counseling (up 9 percentage points) and 85 percent were satisfied with exit counseling (up 12 percentage points). In both entrance and exit counseling, FFEL borrowers were slightly more positive and had a similar (but smaller) change in satisfaction from the previous survey. In our case study visits, we have found FAOs generally comfortable with the Direct Loan entrance and exit counseling process and generally positive about the written (but not video) counseling material that the Department supplies.

Differences in receipt of printed materials and in explanation of loan terms and conditions, repayment options, and consolidation options to students at exit counseling were reported between FFEL and Direct Loan borrowers. A higher percentage of FFEL borrowers reported receiving materials and explanations. (For example, 87% of the FFEL borrowers said they received printed information, versus 80% of the Direct Loan borrowers.) In all cases, the vast majority of both Direct Loan and FFEL borrowers reported receiving these services. However, these differences between programs invite a review of materials that can support counseling of students to better extend customer service to Direct Loan borrowers and promote a more informed borrower as he/she heads into repayment.

Borrower Contacts With the Department of Education

The Department's contact with student borrowers is relatively infrequent; most of the Department's interactions are with institutions. Macro's surveys of borrowers did ask about their experiences with ED or its representatives (which are most likely to be contractors providing loan origination, consolidation, or servicing support). Ninety percent of Direct Loan borrowers reported that overall they were satisfied with their contacts with the Department; the results were identical for FFEL borrowers.

In measuring specific aspects of borrower contacts with ED, all were positive. Direct Loan borrowers said they were satisfied with the helpfulness (83%) and courtesy (84%) of ED representatives. Eighty-five percent of students in the Direct Loan Program were satisfied with the usefulness of information they received from ED, and 82 percent were satisfied with ED representatives' knowledge. At a slightly lower level, 73 percent of Direct Loan student borrowers were satisfied with ED's timeliness in processing and addressing requests. For FFEL borrowers the level of satisfaction was considerably lower—53% reported being satisfied with ED.

Borrower Knowledge

Survey results show borrowers as lacking knowledge of their obligations and program requirements. These findings are important to the Department for consideration of how to improve consumerism on the part of students. Additionally, the loan consolidation process (which will be discussed later in this report) relies on information that must be supplied by the borrower (student or parent), and the Department will assist that process if borrowers become more aware of the details of their borrowing.

In Macro's recent survey of 1996-97 school year borrowers, only 25 percent of student borrowers and 48 percent of parent borrowers knew their interest rate within 2 percentage points of the actual rate. Fifty-nine percent of students and almost half of all parent borrowers (47%) did not know the amount of their most recent loan within 50 percent of the actual amount. In comparing these results with an earlier survey of 1994-95 borrowers, we found that borrowers are less knowledgeable. There were no significant differences between borrowers' knowledge in the Direct Loan and FFEL Programs.

To examine the effectiveness of exit counseling, out-of-school borrowers and transfer students were asked to identify conditions for deferment and consequences of default. Forty-one percent of students were unable to name any of the conditions under which they could defer payments on their loans. While student borrowers were more knowledgeable than parent borrowers about consequences of default, 44 percent of students were unable to cite even one consequence of defaulting on their loan (compared to 55 percent of parent borrowers). Again, borrowers were less knowledgeable in the 1996-97 survey than they were in 1994-95, when asked the identical question.

Electronic Applications

Although not captured through our survey of student borrowers, another area where ED is assisting students is through streamlining the application process. The Department, through electronic versions of the Free Application for Federal Student Aid (FAFSA), is providing a faster, easier, and cheaper way for students to apply and the Department to process aid applications. An added benefit, ED found that because of automatic edits only 0.2 percent of FAFSAs received via the Internet have to be returned because of incorrect or incomplete information (compared to 12% of paper applications). More than 150,000 applications (initial and renewal) have been filed via the Web in 1998. Through the first six months of 1998, electronic applications (in a variety of forms) have increased about 32 percent over the previous period in 1997.

CHAPTER IV. INSTITUTIONAL PERSPECTIVE

Over a four-year period (1995-98), Macro has completed annual customer satisfaction surveys of institutions participating in the Stafford and PLUS loan programs. These surveys are designed to determine the level of institutional satisfaction with the Direct Loan Program and the FFEL Program, specifically related to overall quality and ease of administration, as well as communications and support from the Department of Education (and other service providers). It is primarily the results of the 1998 institutional survey, which was completed between January and April, with 2,256 responding institutions that provide the insights into Departmental administration discussed in this chapter.

Overall Satisfaction

Seventy-one percent of Direct Loan schools responded in our 1998 survey that they were satisfied with the Direct Loan Program (based on ratings of 1 or 2 on a 5-point scale, where 1 was very satisfied and 5 was very dissatisfied). This assessment represents a statistically significant improvement in the ratings from the previous year, when 64 percent termed themselves satisfied with the program. On this same 5-point scale, only 12 percent of schools reported that they were dissatisfied (giving rates of 4 or 5).

There were marked differences in satisfaction among the Direct Loan schools: 71 and 70 percent of the Year 2 (entering in 1995-96) and Year 3 (entering in 1996-97) schools, respectively, expressed satisfaction, while 83 percent of the schools that entered at the program's inception (1994-95) declared themselves satisfied. The satisfaction level of Year 1 institutions is roughly equivalent to the satisfaction level of FFEL schools, where 84 percent said they were satisfied (giving ratings of 1 or 2) with their program.

Over the course of our four surveys, two distinct patterns have developed between Direct Loan and FFEL schools. The highest level of satisfaction in Direct Lending was recorded in the first year (89%). As the program grew rapidly, satisfaction dipped to 83 percent in the 1996 survey and dropped to 64 percent in the 1997 survey. (This drop in satisfaction may have been caused by the significant difficulties encountered, beginning in spring 1997, as the Department transitioned the Direct Loan origination contract from CDSI/AFSA to EDS, coinciding with the time when our 1996-97 institutional survey was in the field.) The current survey result (71% satisfied) displays a rebound in participating schools' appraisal of the program. In the FFEL program, since the introduction of Direct Lending, relative satisfaction of those institutions has increased each year. In the 1995 survey, only 68 percent of FFEL schools expressed satisfaction (in contrast to 89% of Direct Loan schools). Increases were registered in each subsequent year—with 79, 83, and 84 percent, respectively, expressing satisfaction.

Loan Program Characteristics

Institutions were asked to characterize their loans programs by agreeing or disagreeing with various program descriptions. The highest level of agreement for Direct Loan schools was with the statement that "the flexibility of loan repayment options is beneficial to borrowers"—97 percent of responding schools saw that as a characteristic of Direct Lending. Eighty-nine percent of the schools agreed that the Direct Loan Program uses advanced technology.

Additional characteristics listed by a high percentage of Direct Loan schools were that borrowers are well served by the program (88%) and the availability of loan funds is predictable (86%). Sixty-five percent found the program simple to administer, and 73 percent thought it was cost-effective to administer. For each of these four characteristics, the responding FFEL schools provided a significantly higher level of agreement. However, it is notable that first-year schools (those that began at the start of the Direct Loan Program) were significantly more likely to list these characteristics than second-year schools (entering in 1995-96), and their level of agreement generally matched the responses of FFEL schools (with the exception of loan predictability). One critical difference: While only 69 percent of the Direct Loan schools thought the future of their program was secure, 89 percent of the FFEL schools regarded their program as secure.

Ease of Program Administration

Schools have been asked each year of the survey about the level of effort required to administer their respective loan programs (using a 5-point scale: very easy, relatively easy, moderate effort, relatively labor intensive, very labor intensive). The Direct Loan Program remains slightly easier to administer than the FFEL Program—with 47 percent of Direct Loan schools declaring it very or relatively easy, compared to 45 percent of FFEL schools.

Institutions in the FFEL Program have steadily improved their assessment of the ease of administration, starting with only 29 percent in the 1995 survey. The responses of Direct Loan schools indicate that the level of effort associated with program administration has not recovered since the precipitous drop felt between the 1995-96 and 1996-97 academic years, when the percentage of schools considering program administration to be easy or relatively easy declined from 60 percent to 48 percent. The most significant event that transpired in that period was the transfer of loan origination from one contractor to another. (A detailed review of issues associated with that transition can be found in Chapter V.) Site visits conducted during that period confirm that the Loan Origination Center (LOC) transfer was a major source of problems and frustration for Direct Loan schools.

There were significant differences reported among various types of Direct Loan schools in the amount of effort required to administer Direct Lending. For example, four-year public and four-year private universities and proprietary schools said they expended less effort than two-year public colleges. Additionally, the first-year schools (entering at the start of Direct Lending) found the program easier to administer than those who entered later (second- and third-year schools).

On questions of satisfaction with software, Direct Loan schools using EDExpress and FFEL schools had very similar responses to the overall usefulness of their software and processing efficiency. However, in judging ease of integration and compatibility of their software, FFEL schools were more satisfied than EDExpress users, but the Direct Loan commercial software users had satisfaction levels slightly higher than the FFEL schools.

A number of Direct Loan schools (ranging from 20 to 26%) reported that they frequently encountered problems with loan processing. The types of problems cited were transmission of records to or from the LOC, interactions and communications with the LOC, system or software problems, and promissory notes. In terms of the effects on operations, schools reported problems or delays in the following areas: reconciliation, booking loans, receipt of funds, and disbursement of funds to borrowers.

In the 1998 survey, schools were given an open-ended opportunity to list up to two recommendations for improving their respective loan programs. Among Direct Loan schools, the most frequent recommendations involved improvement or simplification of reconciliation (13%), better or faster ED software (9%), more site visits from ED or the regional client account managers (CAMs) (4%), plus 22 percent named LOC issues—specifically, better training or technical support for LOC personnel, improvement in LOC customer service, and the request to not change the LOC again.

ED Support—Materials and Training

Direct Loan schools were asked to rate the usefulness and timeliness of fifteen types of materials and training provided by the Department of Education. In the 1998 survey, just as in the previous survey, a majority of Direct Loan institutions reported that they were satisfied with the timeliness and usefulness of all ED-provided services and materials, with the exception of reconciliation support. The criticism of reconciliation may be connected to the increased attention on reconciliation and frustration schools are feeling due to the requirement that institutions close out all records for 1995-97 (Years 2 and 3) by July 31, 1998.

Direct Loan schools named the following materials most useful and most timely: pre-printed promissory notes, borrower counseling materials, and information on Direct Loan rules and regulations. Least useful and least timely were loan reconciliation support and the Reconciliation Guide. Additional support that was rated low in terms of usefulness was video conferences, and in terms of timeliness, training and technical support.

In comparing responses from Direct Loan and FFEL institutions for the ED-provided materials and training common to both programs, Direct Loan schools were significantly more likely to rate the materials and training received as both useful and timely. In the 1998 survey, for Direct Loan schools there was no significant change in satisfaction levels compared to the previous survey, although satisfaction levels did increase slightly from the previous year. However, there was a significant decline in satisfaction with materials and training detected in an earlier period—between academic years 1995-96 and 1996-97.

Communication with ED Contractors

Both FFEL and Direct Loan schools showed in the 1998 survey a decrease in satisfaction with servicer communications concerning loan repayment and consolidation, compared to the previous year's survey. However, FFEL schools were significantly more satisfied than Direct Loan schools. Seventy-four percent of FFEL schools expressed satisfaction regarding loan repayment communications, compared to 62 percent in Direct Lending. Regarding both in-school and out-of-school consolidation, 60 percent of FFEL schools were satisfied with communications from their servicer, compared to 48 and 44 percent of Direct Loan schools, respectively. The relatively low level of Direct Loan satisfaction can be explained by the fact that acceptance of new applications for consolidation in Direct Lending were suspended from late August through November 1997, due to a massive processing backlog.

Looking specifically at the level of communications and support from the Loan Origination Center (LOC), 60 percent of Direct Loan institutions were satisfied and 16 percent were dissatisfied. When asked to compare their satisfaction for the current year with the previous academic year (the year of the LOC transition), 34 percent found the level of communication and support better and 24 percent reported that it was worse (with 42% indicating it was the same). Direct Loan schools were most satisfied in their interactions with the LOC regarding loan origination (cited by 79%). They were least satisfied with communication and support from the LOC regarding reconciliation, with 68 percent expressing their lack of satisfaction.

Similarly, Direct Loan institutions were asked about satisfaction with the ED loan servicer. Sixty-three percent of the schools were satisfied and 12 percent were dissatisfied, a slightly higher rating than received by the LOC. In comparing the previous year's level of communication and support, 27 percent found the servicer better and 12 percent said that it was worse (61% indicated it was the same). FFEL schools thought that servicer communication was improved in the last year at a similar rate (30%), and 76 percent of schools declared themselves satisfied with servicer support and communication.

Regional Offices and CAMs

ED implemented the Regional Office Client Account Manager (CAM) system in February 1995 to provide support to Direct Lending schools in the form of customer service, technical assistance, and training. In each of the ten Regional Offices, CAMs are a direct point of contact with schools, both initiating calls and responding to requests for information or support. Schools saw their role as that of a facilitator, troubleshooter, and ombudsman.

About three-fourths of Direct Loan institutions reported contact with a CAM in their Regional Office. Most institutions characterized the extent of interaction between the CAMs and their institution as moderate (53%), while 18 percent reported extensive interaction and 29 percent reported very little interaction. The number of schools reporting regional office contact has not varied significantly over time. There were no significant differences in the extent of contact compared to the previous academic year. However, the schools reported less frequent interaction this year than during 1995-96, the first full year in which the Regional Office Account Manager System operated.

Satisfaction with CAM support varied based on the topic area. The most useful and timely types of contact were related to requests for ED-provided material, handling questions regarding Direct Loan policy, and training at the Regional Office. Schools also found the training and guidance delivered by CAMs at institutions to be useful. Regarding their CAM's knowledge of financial aid policies and procedures, 77 percent reported being satisfied, and only 4 percent were dissatisfied. The topic areas where contact was termed the least useful were also cited as least timely: reconciliation issues, computer systems, and disbursement and/or refunding excess funds to borrowers. The second-year schools (those beginning in 1995-96) were typically less satisfied than other cohorts.

CHAPTER V. DEPARTMENTAL PERSPECTIVE

The Department has set an ambitious goal of making ED a high-performance organization by focusing on results, service quality, and customer satisfaction. To review the progress toward this organizational goal, we considered principal areas identified through specific objectives in the strategic plan as areas of emphasis—technology investments, accurate and accessible information, staff skills and performance, leadership, and management (especially of contracts and purchasing). In investigating these areas, a number of consistent themes emerged that may help to illuminate the obstacles that the Department faces in serving both its institutional and borrower customers as well as in meeting its own internal objectives.

We view the current context in which the Direct Loan Program operates as one in which political considerations and budgetary limitations have a powerful influence. These appear to be "givens" in the sense that they are exogenous to the program and not readily changed. There are other operational constraints, some common to government organizations, and other specific to the Department of Education, which provide tangible challenges to the Department's ability to streamline its processes and provide efficient and effective management.

In this section we describe the context and constraints of the Direct Loan Program and then in the next section we focus on some case studies of processes, systems, and issues and consider how these constraints played a role in affecting ED's efforts to achieve results.

Political Setting

The Direct Loan Program was originally proposed as a pilot program, but with the Student Loan Reform Act, passed in August 1993, it was implemented as a full program. Direct Lending was to be phased-in beginning with the 1994-95 academic year, and it was anticipated that it would replace the FFEL Program by 1998. Although originally a Bush proposal, the program was a priority of the Clinton Administration, and strongly identified with the President and his political party. Opposition at the outset included some schools and the business community that provided student financial aid under the FFEL Program (lenders, guaranty agencies, and secondary markets).

Following the Congressional elections of 1994 and the assumption of Congressional leadership by the Republican Party, the Direct Loan Program came under greater pressures to be restricted in size or eliminated. The Department was brought under close scrutiny in terms of its performance. Competition spurred improvement in services among FFEL lenders and servicers, and it was no longer assumed that Direct Lending would replace the FFEL Program. The Department of Education had long-term responsibility for managing FFEL and for service delivery and management of the Direct Loan Program.

The political environment surrounding Direct Lending in 1995-96 had an unsettling effect on institutions who had already committed to the Direct Loan Program (Year 1 and Year 2 schools) and inhibited some schools from signing on for the 1996-97 academic year. Macro's assessment of the Department's activities during that period also reflected less direction in program implementation and a reduction in timeliness in communicating with new (Year 3) schools.

Uncertainty about the Direct Loan Program prevailed until the elections of November 1996 and the drafting of legislation for the reauthorization of the Higher Education Act (HEA). As the hearings on the HEA reauthorization reinforced, competition has been good for student financial aid. Student borrowers and schools have benefitted. The new legislation supports choice of programs. At the same time, legislators and others in the financial aid community have voiced concerns about the systems expertise and financial management experience in the Department to enable the effective management of large, complex systems. As a result, the reauthorization legislation establishes a Performance Based Organization within the Department to oversee the Office of Student Financial Assistance Programs in the future.

It is in this context that the Direct Loan Program was implemented, and many of the problems and major decisions of the Department have played out. Overall, the political setting was repeatedly pointed to in our interviews as a dominant influence. Many managers in the Department, staff employed at the operational level, and others outside the Department cite the highly politicized environment as having undue influence in the decisions that are made and in the consequences of problems that surface. The case studies that follow will demonstrate some specific instances where political considerations played a critical role.

Observers contend that some decisions have been made based on political considerations, rather than what is in the best interest of the customer (borrowers or schools). Some of those within the Department criticized top management of bending to the political winds, looking at political outcomes above all else. One manager noted that in this setting it was hard to get a long-term commitment to serious planning and development. Another relatively recent arrival at the Department saw key decisions based on political concerns rather than business considerations or economic merits, and as a consequence, found that managers were "whipsawed by indecision."

Numerous managers expressed concern about the possibility of lack of support if it were politically expedient. Several individuals described the same incident where an administrator was internally given support to undertake an initiative, and then criticized when it was challenged in the political arena. In another case, a system transition was said, by those nominally in charge, to be unnecessarily delayed because of extreme caution about the fallout from any problem that might occur.

In this setting there has also been a hesitancy to compete head-on with the FFEL Program. Strong advocates for Direct Lending in the Department feel as if the program is being handicapped by the congressional prohibition against pursuing a more aggressive outreach program or the Department's inability to produce more innovative products for borrowers. Greater incentives may be required to encourage large schools to participate.

Finally, the decision to set up a Chief Operating Officer as head of a Performance Based Organization (PBO) to manage the student aid programs has had a profound effect on the organization. For many managers (but not all), the prospect of such an organization with differing restrictions and requirements and a likely reorganization has fostered an attitude of waiting and expectation. People expect things to be different and are less inclined to move aggressively and resolutely; they are waiting to see how the new environment will affect the program. Most are optimistic about what can be achieved with a PBO operating under new rules, but also feel that they are in a "holding pattern."

Budget Limitations

Numerous observers within and without the Department point to the anomaly of running a program to deliver services based on appropriations, rather than the actual amount of services delivered. Although ED is encouraged to think of student loans from a business perspective and to employ current business practices and standards, reliance on a budget from Congress clearly differentiates it. For private lenders, increases in loan volume directly impact their income. To some extent the Direct Loan Program is insulated from having to be as efficient as a business that survives based on the bottom line. At the same time, there is less incentive to improve practices because the benefits are not as direct. In fact, increasing participation in the program means more demands on a fixed sum of money for operations.

By all accounts, the Direct Loan Program was not hampered or constrained by their budget in its initial three years of planning and start-up. Macro's assessment over that period and managers' views of that period substantiate that the Department had adequate resources to accomplish the formidable task of getting a brand new program in place by July 1, 1994. However, in the current context of increased Congressional oversight, reductions from the Balanced Budget Act of 1997, and rising costs, managers cite the difficulty of doing business with such limited resources.

One manager, who has observed the budget situation over the history of Direct Lending, describes the current situation as "fighting each other over scraps." Numerous managers cited consequences of shifting full-time equivalents (FTEs) from one function or activity to another, or of having staffing positions not filled. Several managers cited the impact on headquarters operations of moving resources to fund Client Account Managers, who work with the schools through the Regional Offices. Currently, Accounting and Financial Management Services (AFMS) is operating with 16 FTEs fewer than their allocation. Problems with the Loan Origination processes called for additional ED personnel, but they were not deployed until the servicing contracts were canceled and that staff could be redistributed. Pulling staff together in December 1997 to deal with the Loan Consolidation backlog and related problems has left several areas with a staffing shortfall.

The other budgetary strains come in the systems area. True systems integration runs up against budgetary realities. Numerous managers pointed to fixing the Year 2000 (Y2K) computer problem as being a drain on resources, forcing choices in terms of which program improvements will be undertaken and how comprehensive changes can be. The cost of the Y2K project has escalated as more thorough assessments and validations have taken place. With money needing to be locked in for renovations, the result has been to "vacuum up money" wherever it can be found. One example of limitations put on improvements is with systems improvements for the 1999-2000 school year. Initially $2.5 million in enhancements were requested; staff have met repeatedly about how to allocate the $1 million that is available. In assessing the current situation, staff question the budgeting process and whether money has been well spent. Contractual obligations for systems work frequently experience overruns that other divisions cover, according to several managers. The most frequently lamented project involves the cost of the multiple servicer contracts that were canceled in 1997.

Others, looking to the future, hope that a PBO portends more resources, but more importantly, a different funding mechanism. Managers in the Direct Loan Program would like to see the program operate off its own resources. They complain that the interest from the portfolio should be available for customer support and program improvements. Numerous managers stress that the budget affects how quickly and appropriately the Department can respond to its customers.

In addition to the budget, specific constraints for the PBO's Chief Operating Officer (COO), noted by almost all individuals interviewed, were in contracting and personnel. To some extent these constraints relate to conducting business in the U.S. Government in general. However, numerous observers both in and out of the Department indicated that these issues are particularly restrictive in ED.

Contracting

There are several aspects of the contracting environment related to the Direct Loan Program that has made it subject to criticism.[1] Some people interviewed thought that the Department was more risk averse than other agencies in how contracting rules were interpreted. One consequence of this aversion was a protracted contracting process that often resulted in awarding a contract after the situation had changed. Many at ED complained about the small number and quality of bidders, and indicated they would like to see a broader array of contractors who also do business in the private sector. "Requirements creep" (adding new tasks or procedures) was a practice criticized by persons within the Department as well as those who have observed contracting at ED. Another common practice that was disparaged was the acceptance of the low bid and then issuing change orders and other requests beyond the scope of the contract which would escalate costs.

Systems contracts are highly technical. This is another major area where ED's contracting practice has been criticized. Statements of work tend to be very specific and to dictate the technology to be used, even though ED staff are generally not up-to-date on the latest technology. Many see this practice as tying the hands of contractors who may be able to offer better solutions to ED's needs if only the *outcomes* were specified. At the same time, contract oversight after the contract is issued is frequently inadequate. Observers have criticized the oversight both in terms of the limited amount of time devoted and the lack of technical expertise.

Numerous individuals, both within the Department and without, have questioned the capacity of contract specialists and COTRs to evaluate and monitor complex technical contracts. Even some COTRs have expressed concern about the degree of responsibility they are given for highly visible, multimillion-dollar contracts without sufficient training or resources. A general complaint is that there is no program to keep their skills up to speed. However, COTRs and contract specialists recently did attend training administered by the U.S. Army to help improve the contracting process and specifically to learn about performance-based contracts.

Several persons noted that the current time and materials (T & M) approach to contracting requires more monitoring than ED is able to do. In this environment the government does not have enough information to protect itself from spending too much without constant oversight. One measure currently being tried to better restrain costs and provide more accountability is the use of fixed price task orders.

Shifting to a performance-based contracting approach is advocated by Department leadership as well as outside observers, such as the Office of Management and Budget (OMB). Many note that this move requires a significant change in ED's culture. Because of past problems in contract execution, some involved with the contacting process are uncomfortable with relinquishing control. Advocates of performance-based contracting point to the proscriptive nature of past contracts and their ever-changing requirements as sources of the problems. Philosophically, there is a tension between those who want to gain control and leverage over contracts and those who promote specifying the outcomes and leaving it to the contractor to determine the best way to achieve them.

Complicating this debate over contracting practices is the Direct Lending vision of having one point of contact and for any differences to be invisible to the borrower. The need for consistency in dealing with students has led to imposition of "business rules" of what communications should say, how they are to look, etc. This emphasis runs counter to the performance-based approach. At this time some existing contracts are being "retrofitted" with performance-based incentives that can benefit both the Department and high-performing contractors. Increased flexibility has entered the contracting arena. The Department has also begun to explore (and use) other options such as outsourcing, piggybacking on new contracting vehicles (e.g., a GSA government-wide task order contract), and commercial-off-the-shelf packages (COTS).

The most problematic area in new Direct Lending contracts has been in transitions between contractors. For the most part, handoffs from one contractor to another have produced data that cannot be exchanged, delays in processing, and confusion about where (and how significant) the problem areas are. The handoff of the Loan Origination Center operations and the transfer of consolidation functions were two highly visible transitions that caused problems for students and institutions and reproach from Congress and the higher education community. Transitions are likely to continue as the program improves and expands.

There is a need for parallel systems to ensure a successful transfer and provide a backup if problems arise. This approach applies even when there is no change in contractor, but rather a structural change. For example, in 1996 when the processing of Free Application for Federal Student Aid Forms (FAFSAs) was delayed due to problems with new scanning technology, creating a 4-week processing backlog of approximately 900,000 applications, there was no plan to retain key punch operations for a transition period. A second issue arises when the transfer involves two contractors. In the past, contracts have not been written to provide incentives to a contractor to facilitate a transfer of operations. There is a natural enmity between competing contractors, but the Department needs to build in requirements for documentation, interface testing, and transfer of knowledge into the contract as well as use its leverage of future contracts to promote a successful transfer.

ED has announced its intention to reduce the number of contracts and systems (perhaps contracting by function, rather than by program) and to utilize more effectively performance-based contracting. Actions to support these plans have been limited to date.

Personnel Issues

The ability to hire and fire in the government appears to many to be a major constraint facing the Department. The first issue encountered is how to get the proper skill mix to work in a highly technical environment, where systems knowledge is critical.[2] Numerous managers recounted efforts to hire technical personnel which were hindered by personnel practices and less-than-competitive salaries.

One solution has been to contract out almost all technical work. The result is that there is little, if any, internal expertise, and contractors have more influence than staff would like. Although there are some training opportunities to enhance in-house skills, several managers described efforts as scattershot, with no concerted effort. Consultants, retained on one- or two-year contracts, are also increasingly relied upon.

The Department has also used the Outstanding Scholars Program to bring bright college graduates into the Department. Several managers commented that these individuals cannot reach their potential because there is no mentoring program or formal way to enhance their contribution. Staff charge that these hires are not professionally experienced or familiar with student aid and do not give ED the expertise that is needed.

The lack of a firing capability, except for gross misconduct, also produces an array of problems. Several problems noted by managers were that they often have to rely on a thin layer of capable people (one termed it, "not a very deep bench") and people get burned out from repeatedly being called upon. Non-performers can also cause morale problems. We heard requests from managers for a better way to create incentives for employees.

There also appears to be a gap between career civil servants and political appointees. Given the highly political nature of the Direct Loan Program, perhaps it is natural that long-time employees question the decisions of those who have more of a political orientation. It was said that political appointees have focused on policy and that operational decisions are usually left to senior management, but they are not always in sync. Additionally, conflicts among managers also result in issues being unnecessarily brought to the "top" to resolve.

Three additional constraints on the efficient, effective, and streamlined management of the Direct Loan Program appear to be particularly endemic to the Department of Education. They are addressed below. These limitations relate to the organizational structure to administer the program, the systems that support the program, and problems with lack of accountability. Some may, in fact, be related to the other contextual factors discussed above, but they also directly contribute to dysfunction's in program management and operations.

Organizational Structure

Originally ED's Direct Loan Task Force was formed to provide the structure necessary for developing all policies and administrative functions and for delivering necessary services to institutions to implement the program. This Task Force operated during the first two years of implementation to coordinate the program, overseeing most crucial Direct Loan start-up activities within ED. As the program became institutionalized and with some pressure from divisions who had lost staff to this unit, reintegration of the management functions took place over a period of time. Basic functions returned to the original units: systems to Program Systems Service (PSS); Accountability and Reconciliation Team (ART) to Accounting and Financial Management Services (AFMS); training and publications to Policy, Training, and Analysis (PTAS); and program participation and oversight to Institutional Participation and Oversight Service (IPOS). The remaining Task Force is now advisory, charged with maintaining communication, customer support, and contributing to program operations.

The perception of those within the Department is that something was lost in the reabsorption of the program into functional areas. Where the Task Force gave energy to the program and to those who were committed to it, the program now seems like any other Title IV aid program. One ED official commented that it is hard to keep morale high in a government agency.

It is now not clear what the role of the Task Force is. They are seen as valuable for troubleshooting and problem solving. But there is the feeling that program management has become too decentralized. Getting feedback rather than being *responsible* for program operations has diminished the Task Force's role in decisionmaking and program improvement. Distributing decisionmaking among various functional groups has removed the focal point and the sense that someone or some organization is in charge. Many now point to decisions that do not get made, or that do not get made in a timely way, or that contradict other decisions. Although external political forces are also at work, a number of people interviewed attributed their perception of lack of vision to organizational shifts that have taken place.[3]

At the same time, individuals in functional units outside the Direct Loan Program, who are required to get guidance or input from Direct Loan staff in order to support the program, report difficulties and disconnects in communication. They see Direct Lending as still having favored status in the Department and its staff as not attentive enough to provide critical input on specific projects. Several individuals commented that reintegration had failed, in the sense that Direct Loan is still set apart and does not collaborate to the extent needed. One example described involves the special protections for Direct Loan schools. For a Client Account Manager (CAM) in a Regional Office to refer a problem school to IPOS attention there are a number of barriers. However, only for Direct Loan schools, does the process require that the referral go up the chain of command to the director of CAMs and then to a cross-cutting issues team before IPOS can act.

Committees and work groups are common forms of planning and decision making for the Direct Loan Program. Many people interviewed gave examples of groups of 20 or 30 that promoted delay and conflict and did not make hard decisions. Staff often complained that even with a clear target, e-mails needed to be sent to scores of people and it was hard to get "buy-in" or closure.

As an ED staff member commented, management needs to be more operational and less focused on policy. Although good at idea generation, these groups are "not strategic—they don't focus on how you get there." That perception was echoed by others. Policy is the repeated topic of meetings; operational decisions tend to get delayed while participants wait for perfect information and unanimity of views.

Cases were also cited in which knowledge was not readily shared. Some attributed the problem to lack of a "big picture" or understanding of how things they know about can affect other things. Others ascribed the reluctance to share information as a way of maintaining. In any case, ED staff conveyed frustration at individuals or groups for hoarding information. When groups are engaged in a cross-organizational task, it was felt that they may have different interests to protect and different goals to achieve.

Systems

Direct Lending is a delivery system that is technology-based. Three distinct systems were developed to support the functional needs of the program—the Direct Loan Central Database, the Direct Loan Origination System, and the Direct Loan Servicing System. They join eight other systems to create the infrastructure that supports student financial aid. In the face of rising costs and lack of functionality, the issue of systems integration repeatedly has been raised.[4] One staff member observed that a "window of opportunity" existed when the system was developed to support the new program but that instead additional problems were created with the need to pass data across three systems.

Data quality problems experienced by the National Student Loan Data System (NSLDS) underscore the lack of standardization and redundancy inherent in these multiple systems. The stovepipe structure of systems that developed over many years to meet program needs often hamper accurate, complete, and timely exchange of information. This in turn has led to problems in systems interface, confusion for users, and delays in program operations. NSLDS also reflects the problems inherent with getting data corrected when systems do not talk to each other.

Although systems integration has been a major topic of discussion since the inception of Direct Loans, solutions have been slow in being developed. One manager summed it up: "Integration has not gone as well as we would like." Two major constraints cited were money and expertise. The Department has launched a long-term effort toward modernization with Project EASI but after several years the project is still in the definitional stage and clearly has a long way to go.

As noted in our discussion of contracting, the handoffs between systems has been fraught with problems. Two key handoffs between different systems (and different contractors) resulted in public recognition of the problem. The transfer of Loan Origination functions from one contractor to another left a reported 80,000 cases in error files. Likewise, the backlog that shut down Direct Loan consolidation by Electronic Data Systems (EDS) was the result of cases that could not be resolved, where the transfer of data did not take place.

Another problem that confronts ED is the lack of competition among systems contractors and the establishment of proprietary systems that hamper transfer of data for Departmental management and program improvement. ED staff complain that they cannot even access their own data. One example cited was a contractor charging ED $30,000 just to draw a sample from the database. Until some competition can be introduced among those providing support, staff feel that ED will continue to wrestle with this limitation.

To gain some leverage over both systems and contractors, Program Support Services has initiated a "Band Strategy." In Band 1, automated systems are moved to a common platform. NSLDS was successfully transferred, and moving other systems is planned. Although this step has been supported by many in the Department, the expansion of banding to software development (Band 2) and other activities (Band 3) is being reviewed at high levels of the Department and by

ED's Modernization Board. A number of managers in the Department expressed scepticism about the expansion of this strategy to Bands 2 and 3. Some outside observers saw this approach as an unnecessary step that falls short of modernization and determining a SFA system architecture.

Some observers note that the Government Performance Results Act (GPRA) reporting and the types of data needed to report results may be the push toward integration of systems and information that is necessary to make systems and program delivery more streamlined.

Accountability

With a fragmented organizational structure, as described above, accountability seems to get lost. Many at the Department lamented this situation. Numerous levels were cited as lacking accountability—both senior managers and mid-level managers. It is particularly apparent when there is no natural owner of an effort.

When an activity needs to be coordinated among several groups the process can break down. The printing of promissory notes was delayed this year and arrived at schools late due to exactly such a flawed process. As it was described, no one was in charge of the process; there was not a single person assigned to develop a schedule and shepherd the production from beginning to end. Various groups played the role that was expected of them but without monitoring each step against the end date. No one has looked at this process to see why customer needs were not met. Because Direct Loan issues are scattered across a range of services, it obscures accountability.

In this environment the issue that captures attention is the "crisis de jour." Managers and other staff found numerous examples to cite to support their frustration with lack of accountability that perpetuates a reactive—not proactive—stance.

ED staff interviewed concluded that despite the lack of accountability, managers at many levels of the organization are risk averse. This has led to bad decisions and compromises that frustrate those involved in day-to-day operation of the Direct Loan Program. It is also a frequent target of criticism from those who monitor the Department from afar.

Finally, it is this politically charged and reactive environment has led those within the Department to criticize those assessing ED's accountability. They resent oversight reports from the Inspector General, General Accounting Office, Office of Management and Budget, or the Congressional Advisory Committee. Outside observers with a stake in the management of financial aid reported that their inputs and efforts at improving functions at ED have been rebuffed and criticized. Managers responsible for the program have called these reports "cheap shots" and "destructive."

CHAPTER VI. CASE STUDIES AND KEY ISSUES

In the five years of the Direct Loan Program (through both planning and implementation phases), the program's successes and the constraints faced have been exhibited in program improvements and in system breakdowns. In this section, we describe some of the processes and events that have been critical in the management and maturation of this program.

We begin with descriptions of three major crises that have both perplexed Direct Loan managers and caused public embarrassment for the Department. Reviewing the background and taking a retrospective look at what occurred, we assess the way in which the context and constraints discussed above apply to these specific cases: transfer of the Loan Origination Center, contracts with multiple servicers, and loan consolidation. We then discuss other issues that Macro and others have identified as having been important for the program during the course of the last five years and review their progress.

Loan Origination Center Transition: A Case Study

The Department faces increasing pressures on its systems to handle increasing volume, and it seeks to develop more competitive settings in which contractors will carry out Direct Loan activities. Lessons from the problematic transition of the Loan Origination Center (LOC) should serve to help prevent similar problems and disconnects in the transfer of contractor functions.

Background

The genesis of the transition of loan origination from Utica to Montgomery, as schools often refer to the switch, was that ED desired a more technically robust solution to handle Direct Loan volume and a separation in the origination and servicing activities. These activities were originally concentrated in one contractor, Computer Data Systems Inc. (CDSI) and its subcontractor, AFSA Corporation. Awarded through competitive bid, the new loan origination contractor, Electronic Data Systems (EDS), was to have a new system ready to begin Year 3 operations in January 1996. When EDS was unable to bring a tested system up at that time, ED continued to use CDSI/AFSA until the Department was satisfied that the operations could be transferred. The Department was finally confident that EDS was ready to go and planned for the system to be down for just one week, bringing it back up on March 3, 1997.

Although enormous thought was given to the transition, due consideration was not given to the appropriate operational issues. The Department was in an awkward position when running the first disbursement file took 36 hours. It took several days to discover the problem was related to an expected field not being populated, but in the meantime, data could not be sent back to the schools. Personnel were concerned that once new data were put out on the Title IV WAN, the old CDSI data would not be valid and there would be no possibility of going back to the old system. There was not a good contingency plan—nor any backup plan at all. Schools were caught in limbo, with processing disrupted and no reasonable explanations being give to them. Two months later, five million records had been transferred, 226,000 promissory notes had been acknowledged, and nearly one billion dollars had been disbursed. (Today, the LOC processes 98 percent of loan origination records within 12 hours.)

For a period of time after the transition, there was a clear degradation of service experienced by the schools. The Department was aware of this problem as they tried to work with their new contractor. In preparing for the second attempt at the transfer, a new management team had been put in place by EDS, but the prevailing problem of lack of financial aid experience continued. Although the transition was completed in the obvious sense, problems were just beginning. The major issues were related to the conversion of data, processing and tracking procedures (especially for prom notes), and inadequate customer service.

Observers concede that the EDS loan origination system is more technologically advanced, with a relational database, more rigorous quality assurance built in (e.g., data quality checks, data edits, data communication links), and enhanced reporting. Improvements have now been made in the processing and customer service areas, but this experience provides numerous lessons about planning for and implementing contracting and critical handoffs.

Lessons

From the school perspective, dissatisfaction with EDS resulted from the delays in processing of the electronic manifest, acknowledging promissory notes, and transmission and batch integrity problems. It was exacerbated by customer service problems, including inadequate training in basic customer service, lack of knowledge of financial aid operations and Direct Lending, and lack of responsiveness in following-up on customer problems. Especially because the previous support from CDSI representatives was strong, schools were vocal about their dissatisfaction.

At the root of this problematic transition were deficiencies in the contracting process, coupled with ED-based weaknesses in systems and organization. This situation reflected a lack of collaboration with ED users and other program areas in defining contract requirements and in developing and testing of the new system. The terms and requirements in contracts did not accurately reflect the Department's expectations. Added to that, "requirements creep" led to delays in the development and implementation of the system. Problems also occurred when direction was given to contractors by Direct Loan staff other than the Contracting Officer's Technical Representative (COTR).

In retrospect, ED participants point to underestimating the complexity of loan origination in terms of the systems involved and the conversion problems due to data anomalies. The database conversion consumed the entire period allocated for "down time," and there was no opportunity to run actual jobs to see if the new system worked (although some testing had been done).

One ED staff member noted that the evaluation panel was impressed with the technical solution offered by EDS, and there was inadequate attention to appropriate customer service. Loan origination was seen by EDS as a big processing operation with a customer service component. In reality, it was a big customer service job with a processing component.

Communication about customer service needs and standards were never properly conveyed to the contractor, and therefore, not implemented. As one observer noted, "They thought they were running a customer service call center, but it was really a help desk." Basically, ED felt that the contractor didn't "get it," and the contract had not been designed to achieve the emphasis the Department thought was needed. The first group of customer service representatives (CSRs) had only general knowledge and expected that NCS (the software contractor) would answer EDExpress questions. The customer service delivered by EDS has now been restructured.

Other lessons emerge from this flawed transition. One participant recommends building in a longer period of downtime. In an effort to make the change "seamless" to schools, not enough time was allocated for the transfer and take into account the things that could or would go wrong. Some have criticized ED's actions as crisis management rather than planning. Expectations by both ED and EDS were unrealistic. A general weakness of many ED transitions, there was no parallel processing built in, which especially should have been part of such an important handoff. The tension between the two contractors added to the technical disconnects. ED did not provide any incentives to facilitate this coordination.

A number of ED staff interviewed questioned whether EDS had adequate resources committed to execute the quality operation the Department envisioned. Numerous examples were given by ED personnel about "thin" resources, which can result from a low-bid contract and not-fully-articulated expectations on the part of contracts. At the time of testing and implementation, EDS did not appear to have an adequate number of staff, and equally serious, they were lacking in financial aid experience.

Although MIS reports were a contractual requirement, initially they were not provided and hindered ED's ability to monitor progress. There has been virtually no permanent on-site monitoring in Montgomery since the transition. A number of people who work on the project see that level of monitoring as very important, but there has been a breakdown in responsibility within the Department to obtain the proper staff to carry out this assignment.

Multiple Servicer Contracts: A Case Study

From the initiation of the Direct Loan Program, servicing has been done by the AFSA Corporation, under a subcontract to CDSI. The initial cohort of schools (104) did not put heavy demands on the system, and the operations were able to improve and mature over the course of the first year, with Departmental support, to serve the program's and borrowers' needs. Year 2 (1995-96) demonstrated that the process was more complex and requirements for support in the customer service and servicing technical areas grew considerably. The Department's handling of this need provides lessons for future efforts in contracting and the organizational structure to support the procurement.

Background

Many individuals in the Department were concerned about the capacity of the system (both in terms of customer service as well as technical areas such as disk capacity) to handle the anticipated volume as new schools enrolled and more student borrowers went into repayment. It was envisioned that CDSI/AFSA would maintain its Direct Loan servicing portfolio acquired through the 1996-97 academic year, but would not pick up any additional loans. It would service current loans through their life cycle. At that point, the end of third year of operation, 900,000 borrowers, representing $6.8 billion in Direct Loans, were in repayment.

In 1995, a Request for Proposal (RFP) for multiple servicers to handle the projected demand was issued. Contracts were awarded in September 1996 to three teams of servicers. The number of contracts was said to be based on ED's loan volume estimates of the growth rate, calculated on 3-year histories, (which never materialized) and the individual contractors' ability to support certain volumes. Although the contracts encouraged innovation and competition among vendors, ED planned to provide the specifications for the software and the contractors were required to modify their systems to fit. This was to ensure system uniformity among different contractors. The timeframe envisioned was tight; it called for systems testing by March 1997 and full systems implementation by May 15, 1997.

New servicing contracts were awarded to the following three teams: Electronic Data Systems (EDS), with Kentucky Higher Education Loan Servicing Company; Raytheon/E-systems, with Great Lakes HESC; and ELSC (USA Group), with C&A (a partnership of CDSI and AFSA). At the time, Department officials cited the prior experience of these contractors in servicing FFEL loans, especially in terms of large-scale systems development. Although there was some criticism about expanding to a total of four servicers in light of the loan volume, the argument was put forth that cost savings and performance enhancements would result from competitive servicing.

A team of ED contract and technical staff was assigned to worked closely with each of the three contractors. The teams monitored the development and served as the interface to transmit many of the changes that were directed after the contracts were underway. A whole set of business rules to govern operations were imposed. Numerous delays took place. None of the contractors ever completed the testing phase. Considerable assessment went into whether any (and if so, which) contractors could bring up the expected servicing system. Approximately one year later, on October 1, 1997, the Department announced that it had decided to remain with CDSI/AFSA as the servicer for all Direct Loans. The cancellation of the contracts were said to be based on servicing capacity, cost, and efficient oversight and contract management. The cost of the canceled multiservicer contracts has been put at more than $40 million.

Lessons

Launching these contracts was to have been the beginning of a performance-based approach to contracting. This model established common outcomes for the contractors, while allowing for different approaches as long as the standard was met. The standard was based on level of service to Direct Loan borrowers in repayment. Contractors were initially encouraged to follow innovative approaches in order to take advantage of their strengths and capabilities. Some incentives were built into the solicitation, such as in the area of default prevention.

After the award, however, ED moved away from this approach. During the development stage, the Department provided contractors with stringent business rules. These were additional requirements that changed the way contractors planned on providing their services to the Department. As a result, contracts with servicers had to be modified. Additional ED and contractor resources were spent in modifying and renegotiating the contracts. Now, instead of having just the final version of written correspondence approved by ED, rules dictated the exact language and even the type font for the letters. Besides being frustrating to the contractors trying to bring up new systems, it was frustrating for the teams from the Department overseeing these development efforts. An outside observer noted that laying on the same due diligence requirements that guaranty agencies have will produce the same inefficiencies, which are geared to conform with regulations, not to look at outcomes.

Several explanations have been given for this shift in policy. One is that it became apparent that different servicers with different approaches would interact differently with borrowers. The hallmark of the Direct Loan Program was the consistency of service delivery (a criticism of the FFEL Program had always been the diversity among lenders and guaranty agencies and the confusion it caused for borrowers). Officials desired to put the imprint of the Department on all borrower contacts, to continue with the "oneness" of the process. Others saw this change as an example of the Department's inability to work with performance-based contracts and the reimposition of tight controls to manage contracts, thereby stifling the innovation and competition that was originally intended.

Weaknesses in the contracting process can also be observed in this case. Several in the Department were critical of the process that sets up a panel to write the RFP and then review the proposals. Problems arise because the whole process takes so long (one to two years), and during that time, there is little contact with ED and the changing environment. As the development of the servicing contract was taking place, new ways of looking at servicing were being considered, volume was not reaching anticipated levels, and even the central database system was still being designed.

After contract award, the COTRs and the teams that were monitoring the development of these systems felt removed from the decision-making process. They perceived they were being blamed, while having no authority. On the other hand, some people question the technical capacity of these teams. Ultimately it was the higher management levels that determined that there should be three servicers, made significant changes in midcourse with the business rules, delayed making a decision about how many servicers would go forward, and eventually decided to cancel all three contracts.

There is considerable dispute about why three servicers were selected. Another lesson related to ED's organization and decisionmaking can be taken from this process. Numerous participants cited their preference for just two new servicers, which would introduce some competition. Selecting three to develop their systems was said "to double the costs and triple the complexity." It put both the contractors and the Department's contract monitors in a difficult position that some saw as the fatal flaw that led to the decision to cancel all of the contracts. The current servicer is now in the position of not having competition, and some staff are concerned that this gives them too much leverage.

Although those within the Department have different assessments about the process and the potential of these three contracts, all acknowledge that political climate was a major influence on both the award and cancellation. Having gone forward with large enough loan volume projections to help solidify the future of the Direct Loan Program, the Department really had no choice but to go forward with the search for new servicers to support that volume. When the volume never materialized, political pressure from the Hill contributed to ED's decision to cancel its request. Looking at the whole process in retrospect, numerous individuals within the Department agreed with what one observer called "an expensive lesson." Another noted that there was a real lack of understanding about the *cost* of multiple servicers bringing up different systems. One staff member described the dilemma this way: ED needed to have quality in servicing and felt that the solution might be competition; on the other hand, having a servicing system with competition and serving borrowers correctly may not be compatible objectives.

Future Efforts

Virtually everyone agrees that additional servicing capacity must be acquired. It is unlikely that the same concept of competing technical solutions will be used again. Key ED staff still have differing opinions about how much control to exert over the "look" of the process to borrowers. Some are saying that the model might be multiple servicers working off the same central system. How that central system would be put together (and who "owns" it—ED or the contractor?) have yet to be determined. Other options include linking loan origination and servicing with a new contractor for more capacity or use of a clearinghouse mechanism. Direct Loan supporters would also like to see more servicing options in the future to continue to make the program attractive to borrowers.

Consolidation: A Case Study

The most dramatic issue to confront the Department in the 1997-98 school year was the need to suspend accepting loan consolidation applications effective August 27, 1997. The Department struggled to improve the process and get through the backlog of 84,000 applications that were in process with the contractor, Electronic Data Systems (EDS); set up production targets, performance indicators, and reporting to monitor the processing; remedy errors that had been made in completed consolidations, and re-engineer the process to enhance the capacity, accuracy, and timeliness of consolidation. The loan consolidation transition provide a case study of problem areas in the management of the program, and in specific weaknesses in procurement and contract monitoring.[5]

Background

Consolidation was transferred to EDS from the original contractor, CDSI/AFSA, in September 1996, ahead of the transfer of the Loan Origination Center between the same contractors. There were early warnings of the troublesome nature of consolidation operations. CDSI had a PC-based system that had difficulty handling the volume. The process often required manual intervention; the backlog at the time of transfer had grown to 30,000 applications. The Department delayed the start of the EDS contract for almost 8 months to ensure that they were ready to handle the processing. (There is some dispute about whether the contractor had fully tested the system before it went operational.) In less than a year's time (on August 26, 1997), with increased publicity about the advantages of consolidation, applications surged, and the system broke down. The decision was made that it would be impossible to re-engineer the process while continuing to give service to the new applications coming in. The application process for consolidation was started up again on December 1, 1997.

Lessons

In interviews a variety of ED officials reflected on this experience and find a number of significant lessons about contracting, program management, and the nature of consolidation.

Consolidation is an exceedingly complex task, relying on others outside the system for information and support. ED underestimated internal and external resources necessary to accomplish this process. They invested little in planning, and suffered the consequences.

Critical knowledge about consolidation did not reach those who were implementing this process. ED officials admit that consolidation was not recognized in the Department as a critical ingredient in delivering Direct Loans. A key philosophy in Direct Lending is that borrowers should pay one source. Consolidation had been encouraged, and even some 8,000 defaulted loans were converted. However, ED did not focus on how different consolidation was from loan origination. As an ED staff member noted, although it was treated as such, this is *not* just an origination for a limited number of borrowers, who are informed about the details of their debt. As a consequence, it was a minor part, a deliverable, in the EDS contract, and virtually no ED staff were assigned to this activity. Likewise, the contractor, with limited financial aid background, thought of it as just refinancing, paper gathering.

One observer with an financial aid office (FAO) background highlighted a number of the important and confounding differences. In this interaction ED has a relationship with the borrower. There are ripple effects of working with no financial aid administrator in between. Rather than dealing with 6,700 institutions, there are now thousands of individuals. Every loan profile is different; twenty types of loans could be consolidated, including non-Title IV loans. ED also relied on borrowers for critical information. Macro's borrower surveys show that students do not know details of their loan amounts. Nonetheless, the consolidation application asked borrowers to supply information that they did not know, especially given the dynamic and complex nature of the loan business.

The process also relied on loan holders. Looking at the volume of consolidations that engulfed the process, two-thirds of borrowers requesting consolidation had no Direct Loans at all, but wanted to take advantage of the desirable terms. In essence the Department was buying FFEL assets. That introduced another set of complications for which ED was not responsible. Lenders needed to certify the loans that were being consolidated. Many resisted turning over the more profitable loans. Some lenders, for example, might refuse to certify a borrower who was still in the grace period. Many lenders did not devote the resources required to research and resolve incorrect certificates. The ongoing tension between the lender community and ED did not aid the process. Added to that, EDS had thousands of outstanding (more than a month old) certificates, which slowed down the process and introduced more errors.

Studies by General Accounting Office (GAO) and the Inspector General underscore numerous errors in the data on the verification certificate and in the processing operations. The initial list of lenders and servicers that ED provided to the contractor was outdated and contained multiple addresses. This list was never validated, so the first step in the contacting of lenders was often flawed. An inordinate amount of time was spent resolving inaccuracies in the initial certification process and in the payment process. Both underpayments and overpayments resulted.

Borrowers signed promissory notes that were in error. EDS had massive numbers of files in suspense to resolve problems, and this in turn created more problems.

Participants in the Department also reflected on the contractual weaknesses that contributed to the need to shut down the consolidation applications. Very little was specified in the contract about results—there were no standards, no reference to the strategic plan, and customer service was not mentioned. The bidders (and the successful contractor) had no clear communication from Department about the nature of process, its importance, and the massaging that would have to take place.

The contract was inadequate in terms of what was needed for monitoring the process. There was no requirement for MIS reporting, so that structure was never built. ED learned of the burgeoning problems from two sources—borrower complaints and large overpayments to Sallie Mae—not from any monitoring that was in place. As a condition of reopening, EDS signed a contract modification that put in place performance measures that based the payment structure on the number of days required to consolidate.

In addition to performance-based incentives, there are other improvements in contracting to be derived from this experience. Attention must be paid to how this legal document is written (contractors live up to the explicit details) and to application of selection criteria (ensuring that the contractor has "done it before"). Current ED contracts do not have liquidated damage clauses for not bringing a system up on time (only on key personnel clauses). Others questioned the linking of loan origination and consolidation in one contractor, with an unproven record in financial aid. At a time when increased competition is being sought in contracting, some people argued that putting two major functions into one new contract was probably not a good decision.

The Department has recognized the sufficient resources had not been given to this function. ED and a consulting firm, Price Waterhouse, worked with EDS to analyze the problems and rebuild the process. When applications began being accepted again in December, it was determined that a special loan consolidation team needed to be formed at ED to monitor the process on a daily basis so that a backlog could never happen again. But, more importantly, ED realized that consolidation could not run itself.

The Department resolved to give on-going support to the contractor, especially in the customer service area. ED's commitment of two staff, which contributed to the initial lack of recognition of the problem, has grown to about 15. Although originally thought of as temporary support and monitoring, it appears likely that something like a dozen staff will continue to support this operation. The nature of consolidation is that it is an exception-based process (since virtually everyone is an exception) and requires more resources than EDS expected to put forward in its original bid for this work.

Continued Problems

The ED consolidation team has given primary attention to resolving issues from the earlier backlog period. This process is very labor-intensive, with an ED customer service specialist on the consolidation team handling, on average, three problem cases in a day. ED customer service specialists are hampered, however, by not having complete information on their terminals, requiring them to contact EDS representatives to provide data and assist in the resolution of issues. A common request being handled by the team is the question of the interest waivers during the period of suspension after an application had been submitted. It appears that customer service at EDS offices remains a problem. A baseline customer satisfaction survey of contractor performance that was recently completed shows that there are problems getting through on the telephone and reaching people who are knowledgeable.

Although the immediate crisis is past, observers point to a continued number of uncertainties. Some ED staff think there is still a lot of hand-holding to support EDS. They would like to see stronger contract monitoring of performance. There is still a need for documentation of the system and processes. Adequate systems are not in place in which surveillance of performance and invoicing can be readily monitored. Although the backlog problem is under control, there is apprehension that other mistakes will be made.

One significant area of concern involves the handoff of data from EDS to the servicer (CDSI), who takes over for collection of the consolidated loan. Communications need to be improved. At this point, there are a good deal of error transactions (requiring manual handling) or out-of-sequence transactions. It is reported that some transactions do not reach the borrower's account with the servicer. The result of improper data transfers for borrowers is that they do not get billed, or get billed the wrong amount, or continue being billed by an old loan holder.

Volume is down on new applications, and the improved process seems to be keeping up. Efforts are still underway to clean up errors and rectify customer service issues from the earlier period. ED officials express concern about the effects of increased interest in consolidation, perhaps as a result of changes in interest rates on July 1, 1998, and EDS's capacity to handle the volume. Decisions that still need to be implemented relate to a re-engineering of the process and how to increase capacity in the future. Given the highly visible nature of this system, these decisions are liable to be tempered with political considerations.

Key Issues

While the case studies demonstrate weaknesses in contracting and systems development, ED focused attention on other areas of the program and made improvements that were highly responsive to its school customers. In this section we review issue areas that the Department and the Direct Loan Program has dealt with to see other applied examples of the constraints and challenges that the Department faces. We will consider training, reconciliation, software development, multi-year promissory note development, Year 2000 problem, the National Student Loan Data System, and the Student Status Confirmation Report process.

Training

When Macro began evaluating the implementation of the Direct Loan Program, one of the weaker areas service quality was training. The initial group of schools offered suggestions for improvements that involved taking differing levels of expertise into consideration, providing more interactive sessions, expanding opportunities for those who could not attend the scheduled courses, and making servicer and ED policy staff available during training.

With the development of permanent, state-of-the-art training facilities at the Regional Offices, ED transformed its approach to training. In our case studies we found that in subsequent years ED-sponsored training was generally regarded by schools as useful and cost effective. Besides the increased availability of training and expansion of offerings at Regional Offices, schools applauded the expansion of topics offered and the provision of different training levels from beginner to advanced, as well as the option of on-site training by the Client Account Managers (CAMs) at their institutions.

Those responsible for training have used findings from the Direct Loan evaluation—specifically institutional survey results about training and materials and the case study findings for 1996-97—to further improve training for 1997 and 1998. Specific areas where improvements were targeted were: 1) the use of more problem-solving activities, 2) round table discussions in training for current users to focus on problem resolution techniques, 3) separate training for new and advanced users and course descriptions to specify the proper audience for each course, 4) expansion of on-site training (39 schools were served in the 1997-98 academic year), 5) a focus on mainframe and third-party servicers' needs in guides and in Direct Loan training, and 6) access to training announcements on the web.

Training was delivered on Direct Loans (for new and current users in separate courses), EDExpress application processing, and cash management and data matching (reconciliation) in 1997 in a total of 88 workshops to 2,844 trainees. Those workshops (with the exception of reconciliation), plus EDExpress packaging continue to be offered in the spring of 1998. Additionally, regional training officers offer electronic aid office and NSLDS training that Direct Loan schools might participate in.

There are opportunities for improvement in the training area. ED needs to assure that the training and materials provided to schools will continue to be responsive to their input and changing needs. Weakness in achieving this goal include the following. First, no goals and objectives have been specifically developed for training. A more rigorous approach to design of workshops would assist in making them more supportive of user needs. Second, there is no formal process for incorporating participants' comments. Although evaluation forms are distributed at the training sessions, through 1997 there was no requirement for them to be submitted to headquarters and they were not systematically analyzed. Apparently they will be requested in 1998. Third, timing of training delivery needs to coincide with schools' schedules. A recent example was the training products for the packaging software which came too late to be of use to schools, placing CAMs at a disadvantage in assisting schools. Since the contractor, NCS, develops the training material after the software, there is a 3 or 4 month delay. Training materials are generally rushed because the major focus is on the software. ED staff indicated they would like to see a better product, better communication, and better timing.

Finally, there are an array of guides aimed at Direct Loan schools and the processes they administer. There is a beginning effort in the Department to incorporate all necessary information into one manual. Based on school and ED staff feedback, the effort should make it more accurate and more user friendly. To achieve a quality product, a significant change will need to be made in how the final product is produced. As our earlier discussion of problems associated with organizational structure pointed out, there is a need for someone to take ownership. Experience on other assignments has demonstrated that assimilating the input from all aspects of Direct Loan, making assignments, developing a schedule, and following up are all necessary if this project is to be successful.

Reconciliation

The need to perform reconciliation was a new experience for schools in the Direct Loan Program. Direct Lending is unique among Title IV financial aid programs in requiring this monthly process. Given the electronic exchange of huge sums of money between ED and participating schools, reconciliation was meant to serve as a quality control function to ensure fiscal integrity.

Reconciliation is a Direct Loan process that reflects problems from inattention in the rush to develop and operate a new system. However, the annual improvements in the process since the experience of the first schools underscores the Department's emphasis on customer responsiveness, technical support, and software improvements.

The burden of reconciliation was felt particularly strongly by the schools in the first year of the program. One ED official termed reconciliation, as originally conceived, "onerous." On top of the complexity, numerous problems impeded schools in complying. The first hundred schools in the program were hampered by software problems, lack of training, and limited understanding of the reconciliation process. However, the Department was quite responsive to the schools' needs. Great efforts were made in this area for Year 2 schools, including elimination of bugs in software, greater emphasis on this process by ED through better technical support, and more comprehensive training and manuals. Two forms of reconciliation were originally undertaken (cash records and loan detail records). For the second year forward, schools are only being held accountable for cash drawdowns matching total disbursements.

Academic year 1995-96 problems were easier to resolve because of ED's response to schools' inquiries and servicer's improvements. At the same time, our site visits uncovered that a good deal of problems in the Loan Detail Report were caused by transactions occurring out of sequence. This would occur when prom notes were not processed or not accepted by servicers, rejected origination or disbursement records were not corrected before reconciliation, or loan changes were made before servicer had a disbursement record.

The formation of the Accounting and Reconciliation Team (ART) in March 1996 was another Departmental attempt to help schools properly address reconciliation at the institutional level. They looked at reconciliation in the larger context of the loan process, and helped schools properly originate loans and organize data.

These improvements were thwarted by a significant problem generated when the new Loan Origination Center (LOC) became part of the reconciliation process. Processing delays were common from March to May 1997. The delays were a result of data conversion between the former and current LOC. Given the huge record files and nature of conversion, over 600,000 records needed to be handled manually. The Quality Control contractor worked on-site at LOC for more than 1½ months to complete the process. Frustration was felt by the schools. These delays created increased administrative burden when trying to close out the books for the 1996-97 academic year (Year 3).

The improvements in the process should assist schools in keeping up to date in monthly reconciliations. When the Office of the Inspector General audited some Direct Loan schools in the second year of program operation, they found that more than half failed to perform the process monthly. Reconciliation has evolved into a real-time, LOC-housed process. Monthly account statements similar to bank statements are currently used by schools and ED to perform reconciliation. Reconciliation files are smaller because schools are performing reconciliation in acknowledgment reports. The current year has seen better quality in the processes and a better reporting mechanism. However, schools must still deal with reconciliation from prior years.

The first year's records were closed out in November 1996. The Department is currently assisting schools with the required close-out of Years 2 and 3 (academic years 1995-97) by July 31, 1998. The goal is for institutions and the LOC to resolve discrepancies and leave the schools with a zero cash balance. The issue has been complicated by some schools' inattention to the process as they went along, but more importantly, the LOC conversion. This process involves the final reconciliation of accounts that were affected by data lost through communication and transmission problems, missing promissory notes, and the like. AFMS staff from Washington are assisting EDS in this significant effort. Because they are shorthanded, they are relying on additional support from the CAMs. The closeout will result in schools having a better understanding of the concept of reconciliation, in ED having a better understanding of training that schools require, and in a final cleanup of data problems that emanated from the LOC transition.

Schools and ED officials anticipate that the complexity and frustration over reconciliation will be a thing of the past with the new system being implemented in the 1998-99 academic year. In redesigning this task entirely, the goal was to ensure a school's proper management of funds but to make the process less burdensome. The most significant change is that the LOC will initiate the reconciliation process. Each month the LOC will send schools a Direct Loan School Account Statement (DLSAS) in electronic form. The statement, which looks like a bank statement, will give schools their cash balance on basis of disbursements and cash activities. If there is a cash balance greater than zero, it means that the school has not disbursed or returned all drawn down funds. Schools are required to reconcile the cash balance reported to them by LOC with their internal records. The ART will monitor and contact schools whose cash balances are significantly greater than zero on a consistent basis. Institutions may resolve reconciliation by running queries on EDExpress. Officials call the new approach more intuitive. The resulting process is streamlined and more user friendly, and should minimize the effort required for a process that often was an aggravation for schools.

Software

When the Direct Loan Program began as an electronically-based procedure, some schools had to catch up in terms of their technological capacity. In fact, some found the upgrading of technology at their institution to be an incentive for participation. Schools could use their own in-house software, commercial products, or EDExpress provided by the Department of Education. Schools' decisions about the software package were often influenced by their hardware configuration. For those schools operating a PC-based system or an independent mainframe and PC system, EDExpress was often the software of choice.

At the outset schools had numerous criticisms about the ease of use, efficiency, adaptability to schools' particular circumstances, processing speed, and bugs. Improvements or enhancements have been made on an annual basis, and workarounds are also published for special problems.

Major improvements that have been made, in part in response to requests from financial aid professionals, are the shift to a Windows-based environment, simplified menu, screen-save override, and internal edits to prevent transmission with missing data elements. A major asset incorporated in the 1997-98 version was the change from function-based system to student-based system.

One of the complaints among users, however, has been the frequency with which the software has been updated. For example, five versions of software were released throughout the 1996-97 academic year. In our interviews with Regional Office personnel, they cited software glitches and frequent updates as major frustrations of Direct Lending schools. Now that major bugs have been worked out of the software, and the Direct Loan Program should be in a "steady state," schools would prefer less frequent software versions and updates.

Internally, ED staff also complain about the failure to cut off submission dates for software requirements on a timely basis. ED needs to adhere to cut off dates for software requirements definition and hold developers accountable for established deliverable dates. Schools have requested that they receive new software releases early enough in the year to make appropriate adjustments.

Our more recent studies have elicited the following general recommendations from institutions for software improvements: increase processing speed, make more user friendly, and provide more online help.

Multi-Year Promissory Note

For over two years the financial aid community has advocated the use of an electronic, multi-year line-of-credit promissory note. As part of streamlining processes and decreasing student and institutional burden, the multi-year prom note would allow students to tap into a line of credit that had been established at the time of application. Through either active or passive confirmation, students could access the available funds for each school term, without additional paperwork burdens (reapplication, returning signed prom note, etc.).

A number of factors promoted the pressure for such a mechanism: increased technological capacity, interest among the FFEL lenders for a streamlined process, and the Department's vision of putting more power in the hands of students. Unfortunately, a number of barriers caused the process of reviewing options and planning the pilot study to bog down.

Several constraints affected the stagnation of this initiative. The most obvious was lack of ownership. A number of individuals were identified over time to investigate the feasibility and look at the issues; large meetings, with all potentially interested parties attending, were held. But little progress was made. Specifically, the Office of the General Counsel repeatedly voiced concerns about the enforceability of an electronic process; many found these concerns overly cautious. Others within the Department felt that students were not getting enough knowledge or reinforcement about being borrowers through an easy (almost invisible) process. Some thought that such a process would encourage "unnecessary" borrowing. The result was that in striving for consensus the decision-making process was paralyzed. Until the intervention of the Deputy Assistant Secretary to establish it as a priority item, the project languished. There are still technical and security details and additional safeguards that need to be worked out, but a multi-year prom note now has a scheduled implementation.

An effort has been made in the pilot and for future implementation to balance customer service and consumer protection. In its present status, multi-year prom notes will be available for the 1999-2000 academic year at four-year and graduate and professional schools, and will be the only approved promissory note for FFEL borrowers beginning with the 2000-2001 academic year.

Although fairly close to fruition, many participants cited this as a process in which they were frustrated with varied leadership, repeated delays, lack of follow-through, and ineffective results from decision making by consensus. One active participant said that lessons to be taken from this process are 1) to know where you want to go; 2) listen to all sides and make the necessary choices; and 3) work to have the choices supported by all sides.

Year 2000 Problem

Work on the computing problem that will require systems to recognize a 4-digit date in the year 2000 has not been assessed in previous Macro reports on Direct Loan administration. It is covered in this report to review the degree to which Direct Loan systems and processes are likely to be affected and to gain information about the budget implications of the Department's efforts in this area.

The Year 2000 computing crisis in now being met head-on by ED. Originally the project suffered from inattention, competing priorities, and lack of consistent leadership. In late Spring of 1998 considerable progress was made, stirred in part by the poor grades received from the House Subcommittee charged with oversight and from OMB. Employing the five-phase strategy recommended by the GAO—awareness, assessment, renovation, validation, and implementation—the Department has a compliance schedule and is systematically moving into renovation and validation with the 14 mission-critical systems it is responsible for. The whole process is daunting, likened by one staff member as "going after a mountain with a shovel." Nevertheless, the Department has become committed to completing the process.[6]

Throughout most of this report we have focused on the problems created by stovepipe systems across programs and even within the Direct Loan Program. The stovepipe systems that are endemic in the Department, in this case, allow the work of bringing systems into compliance to be spread out among multiple contractors. The redundancy of systems, although inefficient, also distributes the risk.

The project has enabled the Department to make some gains in assessing and improving old systems. It has taken a step forward in assessing old legacy systems, old code that is no longer used has been dropped, and some parts have been able to be replaced with commercial-off-the-shelf (COTS) packages. The project also developed a complete inventory of data exchanges involving the financial management system and the student financial aid programs, information which will assist in integration efforts.

Throughout the Department, the Y2K project is cited as forcing choices and delaying other technology initiatives such as an electronic signature and FAFSA work. A new, more realistic assessment put its cost at $39.2 million through the year 2000. Costs shot up at the end of March when the Department realized that it spent more money on validation than anticipated by assessing all systems. That cautious approach of assessing all systems was justified, though, when it was determined that three systems, said to be compliant by the contractor, were not.

The Department is developing contingency plans for all mission-critical systems. They also have several risk mitigation strategies in place that include outreach and testing of data exchanges. It is likely that some workarounds will need to be developed. It has also been recommended that ED design a system of front-end computer edits for each of its mission-critical systems. Toward the end of this multi-year process the project team will focus more on assisting external customers, but through such things as Dear Colleague letters they are now raising awareness. They will also be conducting focus groups and surveying schools to assess how ready and knowledgeable they are about the issue. Direct Loan schools may be the best situated because of their use of ED-provided EDExpress software and the Department's minimum system requirement of Pentium computers.

National Student Loan Data System (NSLDS)

The most significant database effort of the Department of Education, the National Student Loan Data System (NSLDS) is designed to as a repository for of data on past and present financial aid recipients. Implemented in 1995, it has continued to grow with inputs from student loan programs (FFEL, Perkins, Direct Loans) and student grant programs (Pell Grants, since 1993). It receives data from the Direct Loan servicer, guaranty agencies and lenders, institutions, as well as enrollment data from schools or the clearinghouse. It will continue to be expanded with data on recipients of other federal grants and work-study. It is being utilized for prescreening applicants to determine those who are ineligible, providing financial aid transcripts (FATs), and sending Student Status Confirmation Reports (SSCRs) to schools to ensure that aid recipients are properly enrolled. Holding over one billion records, it is considered by some in the Department as their greatest technical success—one often overlooked by critics of the Department and its systems. There is no doubt that it has streamlined recordkeeping and data exchanges among the many participants in student financial aid.

For the Department as a whole and for Direct Loan Schools, in particular, a persistent problem has been the quality of the data.[7] Simply stated, the system has difficulties in accepting data and reconciling discrepancies. This problem reflects the basic data quality issues of those supplying the information and the weakness inherent in the lack of integration among the many stovepipe systems that the Department relies on. The system was made to be up and running with a focus on getting the data flowing ("Just getting the pipes laid was hard enough," we were told)—and then, taking a look at quality. Early reports of problems included duplicating every Direct Loan in the system, an eight-month period when no updated information was submitted by the Direct Loan servicer, recalculation of cohort default rates due to database problems, and the exclusion of 12 million loan records due to discrepancies.

Data rejected by edits has decreased substantially: the error rate for guaranty agencies was initially 15 percent and is now 3 percent; for the Direct Loan servicer, the error rate was reduced to 2 percent (from an initial rate of 20-25%). Data providers (especially CDSI, the Direct Loan servicer) still require a good deal of support by the Department. Developing NSLDS underscored the data quality problems that existed across programs and systems. Basic problems exist in the Social Security Number (SSN) and last name identifiers. Some problems have been resolved by loosening the algorithm used for the SSN match, for example.

Users of the data express doubts about the accuracy of such key variables as repayment status. The Department acknowledges a residual lack of confidence about data quality in NSLDS. But the deep-seeded differences in multiple information systems with varying data requirements, definitions, nonstandard formats, and other aspects of data integrity are manifest in this system, and add to labor-intensive resolutions, increasing costs of operation, and continued doubts about data quality.

Direct Loan schools have complained about that a major problem with NSLDS is the difficulty in resolving data discrepancies and updating records with correct information. The financial aid listserv (FINAID-L) is replete with problem cases of FAOs trying to correct or update information and finding that the system is not user-friendly or intuitive. The Department stands behind the data, authorizing its use for enrollment information without peril. However, users in school FAOs still voice concern about data quality from their up-close perspective. The problem is less with the quality of data from Direct Lending, but all that share the system are affected. There is general agreement that measures need to be take to improve the quality data from lenders, in particular, although the Department is hindered by lack of leverage.

Those responsible for NSLDS note a significant technological and organizational achievement when the data processing contract for the system was moved from E-systems to Computer Sciences Corporation (CSC). As part of the cost-cutting "Band" strategy, the Department will consolidate all of its aid data processing at one data center under a GSA performance-based contract. The transition, in February 1998, went smoothly for NSLDS, the first one to be moved. Other systems will be migrated to this common platform over a two-year period.

Student Status Confirmation Report (SSCR)

The Student Status Confirmation Report (SSCR) process was substantially redesigned to reduce the burden on schools. The net result is an improvement for schools, but there were numerous problems with its implementation.

In 1997, with the National Student Loan Data System (NSLDS) operational, the SSCR process was changed from one that required schools to respond to SSCR rosters sent to them by guaranty agencies to one where they needed to update only to a single source, NSLDS. Once schools had at least 90 percent of the student records on their roster accepted into the system, they would be relieved of the responsibility to process rosters from guaranty agencies. They would then receive SSCRs electronically from NSLDS on an established schedule, to be returned within 30 days.

ED officials concede that the initiation of the new SSCR process was flawed.[8] The 1350 Direct Loan schools, which used Title IV WAN, were used to populate the NSLDS. They were asked to verify data for inclusion in NSLDS. Schools were sent a roster of all students in which enrollment status and loan status were in conflict. They were first sent a practice roster and then the actual production roster in March 1997. They were told they had 30 days to correct the data. For some schools, especially community colleges, this involved an enormous number of students (from

1,000 to 8,000). Many schools did a great deal of research, some going back into paper archives. It was particularly burdensome for schools that previously had a manual system. This process, although desirable from the point of data accuracy, cost the Department credibility with schools, and the schools felt unfairly burdened.

Additionally, the Loan Servicing System had trouble processing the volume of data. Direct Loan Schools were not able to see borrower enrollment status changes and effective date changes through multiple iterations of the SSCR update process within NSLDS. It was also concluded after the fact that student addresses are not valid and that schools should not have been asked for them. However, schools now find the SSCR process one that has been significantly streamlined.

CHAPTER VII. CHALLENGES AND THE FUTURE

In less than five years, the Department has developed a program from scratch that wins accolades from borrowers and institutions. Borrowers are extremely satisfied; institutions relish the control they now have over the loan process. These accomplishments need to be viewed in the context of a highly politicized environment and one with budgetary restrictions.

Beginning the Direct Loan Program was much like a start-up company, with the added constraints that the public sector imposes—the traditional government contracting and personnel issues. The program administration suffers from additional internal constraints that have clearly emerged in operating this program: an organizational structure that does not fully support the program, systems problems that resurface in major disruptions to service, and a lack of accountability. Despite attention that has publicly been focused on problems, there are significant areas where ED has been responsive to its customers and moved to improve the integrity of the program.

Individuals both within and outside the Department express some caution about the current status of the Direct Loan Program in the Department and political and budgetary support necessary to nourish the program. As one manager questioned, "With no people and no money, can we keep pulling rabbits out of hats?"

A number of people described the first years of Direct Loan as one of infancy, and see the current period as that of adolescence. The early period was somewhat trouble-free, compared to the "growing pains" that have been experienced in the last two years. In the words of one: "The program was run better than we had thought, but not as well as was needed."

Another ED official reflected on the tension in trying to proceed with modernization, and at the same time, pay attention to the day-to-day delivery of aid. There are lots of choices to be made. Discussions focus on the best way to make a world-class program. The situation was likened to "trying to change the tires on a car moving 70 miles per hour."

Many acknowledge that glitches have hurt the program's reputation. Although critical processes (origination, servicing, and consolidation) are currently functioning and meeting service and turnaround time standards, some outside ED are questioning publicly the overall strength of the systems that support the program. Within the Department, system breakdowns and budget pressures have created a "hardball place to be," according to one veteran.

Several substantial issues for the future emerge:

- Can Project EASI provide the catalyst for the Department to modernize and integrate the discrete programs and processes that are, in fact, integrated in the financial aid office?

- Will the application of the Government Performance Results Act and performance standards help focus attention on what is truly important for Direct Lending and the Department's mission?

- Can the Department move toward performance-based contracting and achieve a better product at a better price?

- What are the next steps for the Direct Loan Program to better serve their customers?

In terms of the latter question, our inquiry has highlighted a number of critical areas. The maintenance of a customer service orientation will be necessary as borrowers come into repayment. Customer satisfaction data are just being collected in that area. Another key area of performance of the Direct Loan Program is repayment outcomes. These will be able to be objectively measured as the full freshman class of borrowers (those that began in 1994-95) moves into repayment status.

There is the challenge of how the Department can keep growing the program. Officials need to consider: What is necessary to attract schools and a diverse set of schools to the program? How can Direct Lending continue to remain innovative?

Outreach currently focuses on informing schools of what it takes to participate. The Task Force has tried to paint a more realistic picture of what it takes to implement Direct Lending. Pairing a prospective school with a buddy in the program has provided valuable support (especially for schools that use a mainframe-PC combination system).

As the FFEL Program has gotten more standardized across lenders, guaranty agencies, and secondary markets and more responsive to customers, the disruption associated with switching to a new system encourages schools to remain in their current program. A single source of capital and "oneness of process" may not be longer enough to attract schools. A number of ED officials are eager for the program to be more proactive, not just reactive.

The Department of Education, the Office of Student Financial Assistance Programs, and the Direct Loan Program are poised for change. The transition to a Performance Based Organization seems imminent. As we have discussed in the section on the Department's perspective, there are established contexts and potential constraints in which this change will take place. There are challenges specifically for the Direct Loan Program that emerged from our review of documentation of the past and our discussions with ED staff. For the most part, they are optimistic about the future, but also realistic about the challenges.

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Student Financial Aid: Schools' Experiences Using the National Student Loan Data System (GAO/HEHS-98-192, September 1998).

Student Loans: Improvements in the Direct Loan Consolidation Process (GAO/HEHS-99-19R, November 10, 1998).

Year 2000 Computing Crisis: Significant Risks Remain to Department of Education's Student Financial Aid Systems (GAO/T-AIMD-98-302, September 17, 1998).

[1] **CONTRACTS:** During the last few years, the issue of insufficient contractual oversight has surfaced in a number of reports from the General Accounting Office (GAO) and in congressional testimony from the Inspector General. Interested readers are referred to the following recent GAO reports: GAO/HEHS-99-19R (pages 3-4 and 21-23), and GAO/HEHS-98-103 (pages 4, 8, 11, and 13-15)—as well as testimony given by the Inspector General on March 20, 1997, before the Subcommittee on Human Resources (pages 8-11), and on July 29, 1997, before the Subcommittee on Postsecondary Education, Training, and Life-Long Learning (pages 2-5).

[2] **PERSONNEL:** This issue has also been raised in the congressional testimony of the Inspector General on at least two occasions—March 20, 1997, before the Subcommittee on Human Resources (pages 7-8 and 10-11), and July 29, 1997, before the Subcommittee on Postsecondary Education, Training, and Life-Long Learning (pages 2-4),.as well as in report S03-60001 (pages 8-10).

[3] For a discussion of the Task Force's role in implementing the Direct Loan Program, interested readers are referred to pages 2-6 of report 503-60001 issued by the Inspector General in June 1996.

[4] **SYSTEMS:** The need for systems integration in the delivery of student financial assistance has received extensive treatment in a number of GAO reports and in the testimony of the Inspector General. In fact, several of these reports have focused exclusively on this topic (GAO/T-HEHS/AIMD-97-132, GAO/AIMD-97-122, and GAO/T-AIMD-97-147), while others have mentioned it in the context of other issues (GAO/T-HEHS-98-124 (pages 10-11), GAO/HR-97-11 (pages 16-17), the testimony of the Inspector General on March 20, 1997 before the Subcommittee on Human Resources (pages 2-5), and on July 29, 1997 before the Subcommittee on Postsecondary Education, Training, and Life-Long Learning (pages 1-2, 5-7)).

[5] **CONSOLIDATION:** Within the last year, two separate GAO reports have focused exclusively on the problems surrounding loan consolidation: GAO/HEHS-98-103 and GAO/HEHS-99-19R, which provide greater detail for some of the issues discussed in this section.

[6] **YZK:** Macro's assessment of ED's progress in solving the Y2K problem is substantially more optimistic than that described in a recently released GAO report titled "Year 2000 Computing Crisis: Significant Risks Remain to Department of Education's Student Financial Aid Systems" (GAO/T-AIMD-98-302 [pages 1 and 5-14]).

[7] **NSLDS:** As noted in several GAO reports (GAO/HR-97-11 (page 6), GAO/HEHS-97-44R (pages 1-7), GAO/HEHS-98-192 (pages 12-13), GAO/AIMD-97-122 (pages 10-11, 19-20), GAO/HEHS-95-89 (pages 17-18)), as well as in a report and testimony from the Inspector General (report S03-60009 (page 24) and in testimony on July 29, 1997 before the Subcommittee on Postsecondary Education and Life-Long Learning (pages 6-7)), data quality issues have been a significant problem for some of those supplying data to NSLDS, as well as for those using the system. However, as mentioned in several of the more recent reports, the Department has made significant progress in reducing the error rate for data residing in NSLDS.

[8] **SSCR:** For an in-depth discussion of some of the problems encountered by schools involved in the SSCR process, interested readers are referred to the Office of Inspector General report "Administration of the William D. Ford Federal Direct Loan Program by Schools" (Control Number 03-60009) (pages 2 and 10-15), as well as GAO report #97-44R (pages 1-7).

Appendix

Response From the U.S. Department of Education

UNITED STATES DEPARTMENT OF EDUCATION

THE DEPUTY SECRETARY

OFFICIAL RESPONSE OF THE
U.S. DEPARTMENT OF EDUCATION

The researchers at Macro International have gathered an impressive amount of information for their report, "Direct Loan Program Administration, 1993-1998." Much of this report will be helpful to the new Chief Operating Officer for Student Financial Assistance.

The Direct Loan program began making student and parent loans in 1994-95. Built with the latest technology, the program delivers funds quickly and reliably. It requires less paperwork than the guaranteed loan program, since students can apply for direct loans on the federal student aid application form, rather than on a separate application. And it offers more flexible repayment options, including income-contingent loans.

The program has faced challenges, as any new program of its size and visibility might. Despite these challenges, the Direct Loan program now makes $11 billion in student loans each year, as many as the 15 largest guaranteed lenders together. Over 1,200 schools chose to join Direct Lending because of the high quality of service it offers students and schools. The Direct Loan program now holds one-third of one of the largest financial markets in the world. 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.

The Direct Loan program has also benefited students and schools in the guaranteed loan program through competition. Surveys show that school satisfaction with the guaranteed loan programs has increased every year since Direct Lending was introduced. Past Macro reports have concluded that "competition between the Direct Loan and FFEL programs has increased overall institutional satisfaction with the loan programs."

A top executive from a prominent guaranteed lender told Student Lending Update last year that the Direct Loan program has "introduced some ways of doing business and some delivery mechanisms that made the 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. It's been relatively good for the industry, particularly for the recipients in terms of students and schools."

The report does not discuss any developments since July 1998. In October, legislation established a performance-based organization (PBO) to administer the federal student aid programs. Congress gave the PBO new flexibility to address the principal issues described by the report. Specifically, the PBO has already begun to recruit personnel with technical expertise, strengthen accountability for performance, streamline procurement procedures, integrate the student aid systems, and identify possible alternative sources of funding. The PBO is led by a Chief Operating Officer (COO) with expertise in management and information technology, who was chosen without regard to political affiliation.

The Department supported and is aggressively implementing this legislation. We began our search for the first COO about eight months before the legislation became law and named the COO four months ahead of the schedule required by the law. We also prepared to reorganize the Office of Postsecondary Education to accommodate the PBO well in advance of the legislation.

Finally, the report cites past concerns of unnamed observers about the Direct Consolidation Loan program. Since last July, our contractor's weekly volume has increased by as much as tenfold. In that time, the program has completed roughly 200,000 consolidation loans, with an average processing time well under the industry standard of 60 days.

Marshall S. Smith
Deputy Secretary (A)