



Testimony

Before the Subcommittee on Government Operations, Committee on Oversight and Government Reform and the Subcommittee on Higher Education and Workforce Training, Committee on Education and the Workforce, House of Representatives

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# FEDERAL STUDENT LOANS

## Key Weaknesses Limit Education's Management of Contractors

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Accessible Version

# GAO Highlights

Highlights of [GAO-16-196T](#), a testimony before the Subcommittee on Government Operations, Committee on Oversight and Government Reform and the Subcommittee on Higher Education and Workforce Training, Committee on Education and the Workforce, House of Representatives

## Why GAO Did This Study

During fiscal year 2014, Education issued more than \$99 billion in Direct Loans to 9.4 million borrowers. Education contracts with and monitors the performance of servicers that handle billing and other services for borrowers, and entities that support rehabilitation of defaulted loans. In 1998, federal law established FSA as a performance-based organization, giving it more flexibility to manage operations, including Direct Loans.

GAO's testimony focuses on: (1) how effective FSA's instructions and guidance to servicers are, (2) how well FSA monitors and documents calls between Direct Loan borrowers and servicers, and (3) the status of FSA's oversight of the defaulted loan rehabilitation process. The first two questions address recently completed GAO work on FSA's oversight of servicers and communications with borrowers. The third question reflects results of GAO's previously issued work. GAO reviewed FSA's contracts, policies, procedures, instructions, and guidance; analyzed its monitoring reports and processes; and reviewed relevant federal laws and regulations. GAO also interviewed federal officials, including officials from FSA, servicers, and representatives from higher education associations. We shared our findings with FSA officials and incorporated their comments as appropriate.

## What GAO Recommends

GAO is recommending that FSA (1) review and improve how it provides instructions and guidance to servicers, (2) improve its methodology for monitoring calls between servicers and borrowers, and (3) improve documentation of its call monitoring.

View [GAO-16-196T](#). For more information, contact Melissa Emrey-Arras at (617) 788-0534 or [emreyarrasm@gao.gov](mailto:emreyarrasm@gao.gov).

November 18, 2015

## FEDERAL STUDENT LOANS

### Key Weaknesses Limit Education's Management of Contractors

#### What GAO Found

The Department of Education's Office of Federal Student Aid's (FSA) instructions and guidance to loan servicers are sometimes lacking, resulting in inconsistent and inefficient services to borrowers. While FSA has taken some steps to improve program instructions and guidance, six of the seven servicers GAO interviewed reported various issues resulting from absent, unclear and inconsistent guidance and instructions from FSA. For example, one servicer said there are no instructions for how to apply over- or underpayments to borrower accounts. In other cases, guidance is unclear; for example, according to one servicer, there is insufficient guidance on how to handle reporting certain types of adverse credit history to credit bureaus. Furthermore, in certain instances when FSA provided additional guidance or clarifications, it did not consistently share them with all servicers. Federal internal control standards state that information should be communicated in a form that enables entities to carry out responsibilities. Without improved guidance and instructions to servicers, borrower finances or the integrity of the Direct Loan program could be negatively affected.

FSA monitors calls between servicers and borrowers, but there are weaknesses in the processes for selecting calls to be monitored and for documenting results. For example, FSA monitors far fewer outbound than inbound calls, even though one servicer said it makes 60 times more outbound calls than it receives inbound calls, and outbound calls are often made to borrowers who are delinquent and at risk of default. Also, the methodology for selecting recorded calls for review is not well-defined and relies on servicers to implement, with no verification from FSA to ensure its integrity. This does not align with the Office of Management and Budget's best practices for developing sample designs. In addition, the overall results of the call monitoring are poorly documented. For example, summaries of monitored calls did not consistently track errors over time. FSA's Strategic Plan calls for enhancing customer-facing processes, but FSA's call monitoring leaves management without complete information it needs to understand how well servicers interact with borrowers.

FSA has taken some steps to improve its oversight of the defaulted loan rehabilitation process in response to GAO's March 2014 report. Loan rehabilitation allows eligible borrowers who make nine on-time monthly payments within 10 months to have the default removed from their credit reports. In March 2014, GAO found that FSA was unable to provide most eligible borrowers who completed loan rehabilitation with timely benefits, such as removing defaults from their credit reports, for more than a year after upgrading the information system it uses to manage defaulted loans. As a result of limited planning and oversight of its system contractor, no rehabilitations were processed from October 2011 until April 2012, and FSA officials said they needed until January 2013 to clear the resulting backlog. GAO recommended that FSA take steps to track loan rehabilitation performance and improve oversight of its system contractor. FSA agreed with the recommendations and has begun taking action to address them.

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Chairman Meadows and Chairwoman Foxx, Ranking Members Connolly and Hinojosa, and Members of the Subcommittees:

I am pleased to be here today to discuss the results of our work examining the Department of Education's (Education) efforts to monitor and oversee the Direct Loan program. Federal student loans play a crucial role in ensuring access to higher education for millions of students each year. In fiscal year 2014, Education issued more than \$99 billion in Title IV student loans to 9.4 million borrowers under the William D. Ford Direct Loan (Direct Loan) Program. Through the Office of Federal Student Aid (FSA), Education administers student financial aid programs—including the Direct Loan program—that are authorized under Title IV of the Higher Education Act of 1965, as amended,<sup>1</sup> and oversees the performance of contractors supporting these programs. These contractors include loan servicers responsible for billing and other services, as well as companies managing the department's defaulted loan information system. Under the Direct Loan program, FSA issues and manages the loans while contractors service them.

To address longstanding management weaknesses – including Education's vulnerability to losses due to fraud, waste, abuse, and mismanagement –the Higher Education Act was amended in 1998, to establish FSA as the first federal performance-based organization (PBO).<sup>2</sup> A PBO is intended to transform the delivery of public services by committing to achieving specific measurable goals with targets for improvement, in exchange for being provided with more flexibility to manage its operations. Accordingly, FSA's strategic plan includes several goals focused on monitoring contractors and serving the needs of borrowers. However, recent questions have been raised about FSA's management of the Direct Loan program, including its oversight of contractors. These include both loan servicers responsible for servicing

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<sup>1</sup>Pub. L. No. 89-329, 79 Stat. 1232-1254, codified at 20 U.S.C. §§ 1070- 1099d and 42 U.S.C. §§ 2751-2756b. These programs include the William D. Ford Federal Direct Loan Program, the Federal Family Education Loan Program, Pell Grants, and various campus-based programs.

<sup>2</sup>Higher Education Amendments of 1998, Pub. L. No. 105-244, tit. I, § 101(a), 112 Stat. 1581, 1604, codified as amended at 20 U.S.C. § 1018.

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the needs of borrowers and contractors managing the department's defaulted loan information system.<sup>3</sup>

My statement today provides findings from our recently completed work on FSA's management of the Direct Loan program and our prior published work on loan rehabilitation<sup>4</sup> and will focus on: (1) how well FSA provides instructions and guidance to Direct Loan servicers, (2) how well FSA monitors and documents calls between Direct Loan borrowers and servicers, and (3) the status of FSA's oversight of the defaulted loan rehabilitation process.

The performance audit work to develop our analysis of FSA's instructions and guidance to loan servicers, as well as its monitoring and documentation of calls between borrowers and loan servicers, was conducted from May 2014 to November 2015. For this work, we assessed FSA's instructions and guidance to servicers and its call monitoring procedures against federal internal control standards, FSA's strategic plan, and the Office of Management and Budget's standards for statistical research. In addition, we reviewed FSA's policies, procedures, instructions and guidance related to Direct Loan servicers; FSA's contracts and monitoring plans for Direct Loan servicers; and relevant federal laws and regulations. We also analyzed information from FSA's monitoring of servicers' calls with borrowers, and other compliance monitoring documentation. We interviewed officials from FSA, Education's Office of the Inspector General, and the Consumer Financial Protection Bureau. We also interviewed representatives from all four Title IV Additional Servicers and three not-for-profit Direct Loan servicers – which together represent over 90 percent of the federal student loan

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<sup>3</sup>Default generally occurs when a borrower fails to make a payment for more than 270 days. However, FSA generally identifies defaulted loans as those that are 360 days or more past due, because loan servicers have 90 days to transfer Direct Loans to FSA's Default Resolution Group.

<sup>4</sup>Loan rehabilitation is one way borrowers can get their loans out of default. Borrowers who make nine on-time monthly payments within 10 months may be eligible for loan rehabilitation, which entitles them to have the default removed from their credit report.

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portfolio – and reviewed documentation from each.<sup>5</sup> In addition, we interviewed representatives from several higher education and other associations that include as members—or represent the interests of—schools, borrowers, loan servicers, or financial aid professionals. We shared our findings with FSA officials and incorporated their comments as appropriate.

The information regarding FSA’s oversight of the defaulted loan information process is from our March 2014 report on this issue.<sup>6</sup> For this report, we reviewed policies, procedures, and guidance; contracts and monitoring records for FSA’s system contractor; fiscal year 2011-2013 collections and rehabilitation data;<sup>7</sup> and relevant federal laws and regulations. We interviewed FSA officials, its defaulted student loan system contractor, and borrower advocacy and consumer protection groups. We also reviewed information FSA provided on actions it has taken to address recommendations since March 2014.

The work upon which this statement is based was conducted in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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## Background

Under the Direct Loan program, FSA issues several types of loans to students and their parents, including Subsidized, Unsubsidized, and

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<sup>5</sup>Loan servicing for the Direct Loan program used to be handled by a single contractor. In 2009, four Title IV Additional Servicer (TIVAS) contracts were awarded as part of FSA’s strategy to improve servicing performance by fostering competition among vendors. In addition, not-for-profit (NFP) servicers began servicing loans in October 2011. One of the not-for-profit servicers we spoke with, Aspire, chose to leave the federal student loan market in September 2015.

<sup>6</sup>GAO, *Federal Student Loans: Better Oversight Could Improve Defaulted Loan Rehabilitation*, [GAO-14-256](#) (Washington, D.C.: March 2014).

<sup>7</sup>These years coincided with an upgrade to the defaulted loan information system. We assessed the reliability of these data by (1) performing electronic testing of required data elements, (2) reviewing existing information about the data and the system that produced them, and (3) interviewing agency officials knowledgeable about the data. We determined that the data were sufficiently reliable for the purpose of our report.

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PLUS Loans.<sup>8</sup> The federal government sets limits on the interest rate, loan origination fees and other charges, and annual and aggregate amounts that can be borrowed. There are several repayment plans available to borrowers, including a range of income-driven repayment plans.<sup>9</sup> In addition to being in repayment status, loans may be in: (1) deferment: a period during which repayment of a loan is temporarily suspended—such as while a student with undergraduate loans pursues additional higher education, or in (2) forbearance: a temporary postponement, extension, or reduction of loan payments for up to 12 months that is authorized when a borrower cannot make scheduled payments for certain reasons, such as financial hardship. Interest continues to accrue on loans in forbearance, while the government pays the interest on subsidized loans in deferment. While loans are in repayment, deferment, or forbearance status, they are serviced by contracted service providers.

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## Management of Defaulted Student Loan Information System Upgrade

In 2003, FSA entered into a 5-year, performance-based contract known as Common Services for Borrowers to improve the management of student loans following disbursement.<sup>10</sup> The contractor was the sole loan servicer for the Direct Loan program and was also expected to modernize and integrate four separate information systems, including for loan servicing and debt collection. However, the contractor experienced significant software development delays and FSA canceled the systems integration effort in May 2007. FSA then began exploring options for upgrading the defaulted loan information system in 2009, and invited six firms, including the

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<sup>8</sup>For Subsidized loans, the government pays the interest that accrues while borrowers are in school, during a 6-month grace period after leaving school, and during periods of deferment. For Unsubsidized loans, interest accrues while the borrower is in school or may be paid by the borrower. PLUS loans are available for graduate or professional degree students and parents of dependent undergraduate students, and borrowers are responsible for paying the interest. FSA also issues Direct Consolidation Loans, which allow borrowers to combine multiple existing federal student loans into one loan with one resulting monthly payment. Consolidation loans may allow borrowers to extend their repayment period to up to 30 years, thereby reducing monthly payments.

<sup>9</sup>Income driven repayment plans can help borrowers manage their debt by basing repayment amounts, in part, on borrowers' income. Key features of these income-driven repayment plans range from lower monthly payments and repayment periods of up to 25 years, to forgiveness of any remaining loan balances at the end of the repayment period.

<sup>10</sup>Performance-based contracts specify the desired outcomes and allow the contractor to determine how best to achieve those outcomes, rather than prescribe the methods contractors should use.

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original system contractor, to submit proposals. The original contractor subsequently offered to upgrade the system at no additional cost to the government. In June 2010, FSA canceled the request for proposals and modified the original contract to include the upgrade.

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### Performance-based servicing contracts and oversight

Beginning in 2009, FSA entered into performance-based contracts with additional loan servicers. These contracts were awarded as part of FSA's strategy to improve servicing performance by fostering competition among vendors. Currently, FSA has contracts with four Title IV Additional Servicers (TIVAS) and six not-for-profit (NFP) servicers.<sup>11</sup> Loan servicing includes such activities as communicating with borrowers about the status of their loans, counseling borrowers on selecting repayment plans, and processing payments.

In administering the Direct Loan program, FSA uses numerous tools and activities to oversee the performance of its contractors, including loan servicers and others that provide services in support of student loan administration. FSA issues instructions and guidance to servicers to manage the program that range from guidance on day-to-day operations to contractual changes servicers must implement. In addition to providing written communications, FSA meets with servicers to discuss program operations and policy. FSA also conducts various monitoring activities, including monitoring selected calls between servicers and Direct Loan borrowers to ensure both acceptable customer service and servicer compliance with statutory, regulatory, and contractual requirements.

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<sup>11</sup>The not-for-profit service contracts were first awarded in 2011. As of October 2015, FSA had contracts with the following 10 servicers for the Direct Loan program: (1) Four TIVAS: Great Lakes, Pennsylvania Higher Education Assistance Agency/FedLoan, Navient, and Nelnet; and (2) Six NFPs: Missouri Higher Education Loan Authority, EdFinancial, Granite State, Vermont Student Assistance Corporation Federal Loans, CornerStone, and the Oklahoma Student Loan Authority Servicing. A seventh not-for-profit servicer, Aspire, chose to leave the federal student loan market in September 2015.

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## Lack of FSA Guidance and Instructions to Servicers Results in Inconsistent and Inefficient Services to Borrowers

Some FSA guidance and instructions to servicers is inadequate, resulting in inconsistent and inefficient services to borrowers. While FSA has taken some steps to provide more Direct Loan program guidance and instructions to servicers, six out of the seven servicers we interviewed reported various issues resulting from absent, unclear, and inconsistent guidance and instructions from FSA.<sup>12</sup> As a result, borrowers are likely to have different experiences with the Direct Loan program.

FSA has made some effort to respond to servicers' concerns about its program instructions. For example, in a white paper to FSA, three servicers suggested ways FSA could improve how it provides instructions on program changes. In response to these suggestions, FSA officials told us that they are planning to implement training on the current process for providing instructions in November 2015, and that they now discuss each new instruction with servicers, including any instruction that needs clarification. In addition, FSA officials said they recently put a number of processes in place to assist servicers with implementing a new income driven repayment plan,<sup>13</sup> including job aid documentation to help servicers with their development of training and systems. Nevertheless, we identified a number of inconsistencies caused by a lack of guidance and instructions, such as the following:

- One servicer we interviewed reported that there is a lack of instructions from FSA for some aspects of the Direct Loan program, such as how to apply borrower over- or underpayments to a borrower's balance. This servicer stated that it is clear how they should generally apply borrower payments to student loan balances; however, if borrowers do not provide specific instructions on how to apply a payment that is over or under the monthly payment amount, servicers then have to decide how to apply this to the borrowers' balances. For example, according to this servicer, if a borrower has multiple loans, some servicers spread an overpayment amount evenly across all loans, but other servicers target the higher interest loans first. This servicer also said that FSA has not communicated with

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<sup>12</sup>FSA officials told us that instructions to servicers, often in the form of a change request, enable FSA to make program changes on an as-needed basis.

<sup>13</sup>In October 2015, the Department of Education issued a final regulation establishing a new income-driven repayment plan, the Revised Pay As You Earn (REPAYE) Plan to expand repayment options to more borrowers. REPAYE is scheduled to be implemented in December 2015.

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them on how to standardize application of such payments. FSA officials stated that they are in the process of working with the Consumer Financial Protection Bureau on establishing a consistent approach for the application of over- and underpayments, but they do not know when this will be finalized. They added that any related requirements for servicers would likely be included when they recomplete servicer contracts in early 2016.

- A servicer reported that FSA does not provide sufficient guidance on all documentation that is allowable for income-driven repayment plans, and as a result, each servicer is left to interpret what some of their borrowers submit for proof of income. For example, some servicers treat retirement benefits as income, while others do not. This could potentially cause similarly situated borrowers in the same income-driven repayment plan to have different monthly payment amounts or prevent some from qualifying, depending on who services the loan. FSA officials acknowledged that due to difficulties in deciphering alternative income documentation, servicers could interpret income differently. They also stated that it is difficult to craft guidance that would address the range of these issues. In addition, officials told us that they have finalized a new income-driven application protocol that further outlines processing rules and guidelines.<sup>14</sup> However, this protocol does not provide additional guidance on how servicers should interpret income documentation.
- Three of the servicers we interviewed said FSA has not provided clarification on industry guidance for credit reporting that FSA has directed them to follow. For example, because the industry guidance does not account for specific aspects of the Direct Loan program, it is unclear how servicers should handle credit reporting for unique, program-specific borrower statuses, such as borrowers who had poor credit reports filed right before they were approved to postpone or reduce their payments. As a result, some servicers removed bad credit reports for some borrower statuses while others did not. FSA officials said they were aware of issues with inconsistent credit reporting, and were coordinating with other federal agencies on a review to better understand the impact of student lending on a consumer's credit score, and that it will be the basis for issuing

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<sup>14</sup>FSA officials also described some improvements to how they collect documentation on income information through the tax return process, such as enhancing the income-driven application process in 2012 to allow a borrower to transfer income information directly from the IRS.

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guidance to create consistency in credit reporting. However, FSA officials could not tell us when this review will be completed. They said that when the review is finished, they expect to implement the new guidance next year.

- FSA is not consistently sharing all clarifications on Direct Loan program instructions with all servicers. Servicers told us that when they ask follow up questions about instructions from FSA, FSA does not routinely share its responses with all servicers, resulting in different servicers potentially receiving different information about the same instructions. For example, one servicer we interviewed expressed concern with the lack of clarity in FSA instructions to address differences across servicers on how interest is applied to loans. According to FSA officials and one servicer that we spoke with, FSA has taken some action to address this lack of consistent instructions, including implementing a new directive to standardize the treatment of interest, developing test scenarios for servicers to use to ensure requirements are consistently implemented, and forming a work group of servicers and FSA staff on this issue. However, this same servicer also pointed out that despite these efforts, additional FSA guidance is in process and still outstanding, and FSA continues not to share questions and answers or clarifications on this issue. FSA officials stated that due to the complexity of the program not all guidance was applicable to all servicers, however they plan to move toward a more consistent process when they recompile servicer contracts in early 2016.
- Servicers expressed the need to further standardize certain aspects of the Direct Loan program and offered several suggestions for improving program servicing consistency through better guidance and instructions. For example, five out of the seven servicers we interviewed stated that overall, they would like FSA to provide more information and clarity on FSA's instructions. Four servicers also expressed the need for a common manual for Direct Loan servicers, similar to the one that exists for the Federal Family Education Loan (FFEL) Program—a program under which loans were provided by nonfederal lenders and repayment guaranteed by the federal

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government<sup>15</sup> that would describe and help clarify current student loan requirements.<sup>16</sup> While FSA and servicers share information about the Direct Loan program with borrowers in multiple ways – including online and by email and mail – there is no single manual like this that servicers and borrowers have access to. One higher education association representing financial aid professionals said such a manual should be made widely circulated so borrowers can confirm information on the Direct Loan program themselves. FSA officials told us that when they begin the process of re-competing the contracts for Direct Loan servicing next year, they will evaluate the need for a common manual.

One of FSA’s strategic goals is to “develop efficient processes and effective capabilities that are among the best in the private and public sectors,” and federal internal control standards state that information should be communicated to those who need it, in a form and within a timeframe that enables them to carry out their responsibilities.<sup>17</sup> Without clear, sufficient, and transparent guidance and instructions to ensure that the Direct Loan program is executed more efficiently and effectively among servicers, borrowers may continue to have inconsistent experiences with the program.

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<sup>15</sup>For many years, essentially the same set of loans available under the Direct Loan program were also available through the Federal Family Education Loan (FFEL) program. In March 2010, the Student Aid and Fiscal Responsibility Act, enacted as part of the Health Care and Education Reconciliation Act of 2010, terminated the authority to make new FFEL loans after June 30, 2010. Instead, borrowers who would have been eligible to receive FFEL loans could receive loans made by Education under the Direct Loan program.

<sup>16</sup>The FFEL Program *Common Manual* contains up-to-date federal student loan information, and is designed to help train new financial aid and student loan personnel and to assist the experienced officer in finding answers to questions about federal regulations and policies. The Common Manual provides a single, standardized set of current student loan rules and FFEL policy guidance for schools and lenders.

<sup>17</sup>GAO, *Standards for Internal Control in the Federal Government*, [GAO-AIMD-00-21.3.1](#) (Washington, D.C.: November 1999).

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## FSA's Monitoring of Calls between Servicers and Borrowers Has Methodological Weaknesses and Is Poorly Documented

Key weaknesses limit FSA's ability to monitor servicers' interaction with borrowers and ensure servicers provide accurate information and good customer service. FSA's Strategic Plan includes a goal to provide superior service and information to borrowers, including taking a data-driven approach to better understanding customers and enhancing customer-facing processes to improve the customer experience.<sup>18</sup> As part of its oversight of Direct Loan servicers, FSA monitors a sample of live and recorded telephone calls between servicers and borrowers, with the stated aim of ensuring exceptional customer service with the greatest accuracy.<sup>19</sup> FSA officials told us they began call monitoring in 2004, but until recently, the agency only monitored incoming calls, which are calls that servicers receive from borrowers. It also did not include any calls from a subcontractor one large servicer was using, even though the subcontractor made most of that servicer's calls to delinquent borrowers. In January 2015, in response to a report from Education's Office of Inspector General, FSA began monitoring incoming calls to all subcontractors, and soon afterward began monitoring outbound calls from servicers and subcontractors.<sup>20</sup>

However, we found that FSA's approach to call monitoring contains notable methodological weaknesses. Our analysis of FSA's monthly reports since it started reporting on outbound calls in March 2015 through July 2015 shows that, of all calls FSA monitored, outbound calls constituted an average of only 9 percent. FSA officials told us they do not know how many outbound calls servicers make, but noted they are far more prevalent than inbound calls. They added that some outbound calls result in a servicer leaving a message rather than having direct contact with a borrower. However, one servicer told us it participates in over 60 times more outbound calls than inbound calls, and all seven servicers we spoke to said outbound calls were a primary method of contacting borrowers in delinquency and approaching default. Therefore, by focusing its efforts primarily on inbound calls, FSA may not be focusing its call monitoring on the most frequent and critical types of calls.

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<sup>18</sup>*Federal Student Aid Strategic Plan, FY 2012-16*, U.S. Department of Education, Office of Federal Student Aid, December 2011.

<sup>19</sup>*Draft Operations Services Monitoring Procedures*, U.S. Department of Education, Office of Federal Student Aid, (March 30, 2015).

<sup>20</sup>*The U.S. Department of Education's Administration of Student Loan Debt and Repayment*, U.S. Department of Education, Office of Inspector General, (December 2014).

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In addition, FSA relies on servicers to select recorded calls for its review but has not developed a rigorous methodology that would produce a consistent process among servicers. FSA officials told us that, in the aggregate, approximately 60 percent of the calls they review are live, while the other 40 percent are recorded, though the percentages vary by servicer. For recorded calls, the only guidance FSA provides servicers is that calls should be random; the office does not further delineate how it wishes servicers to select calls to ensure they follow a comparable process. Specifically, FSA's Monitoring Procedures guide states that FSA will review a sample "taken from randomly provided recorded calls," without defining additional parameters, such as whether to draw a random sample from all calls or to ensure the sample includes calls on specific topics. FSA officials confirmed that they do not have specific methods for how servicers should select calls to send, nor do they verify the servicers' call selection process to ensure both its integrity and that calls are being selected in a consistent manner over time and across servicers. The Office of Management and Budget's (OMB) best practices for conducting data collection state that agencies should ensure sample designs will yield the data required to meet the data collection effort's objectives — in this case, ensuring servicers provide exceptional customer service to borrowers with the greatest accuracy.<sup>21</sup> Without a more rigorous methodology and verification process, FSA cannot ensure it reviews a good representation of calls between borrowers and servicers, or that its review is comparable across servicers and across time. FSA officials said they are in the process of implementing more detailed guidance to servicers on selecting recorded calls for review, and they hope to finalize it before the end of the year. According to the draft guidance, servicers will provide a large sample of calls from which FSA will select a subsample. If implemented, this method of selection could provide greater consistency than the current process. However, FSA plans to instruct servicers to include only half as many outbound calls as inbound calls in their sample.

Furthermore, the results of FSA's call monitoring are poorly documented, limiting their usefulness for management purposes. Standards for Internal Control in the Federal Government state that information should be

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<sup>21</sup>Office of Management and Budget, *Standards and Guidelines for Statistical Surveys* (September 2006). Although FSA's call monitoring samples are not intended to produce results with which to generalize, FSA uses them as an indicator of whether servicer call centers are accurately providing information to borrowers on the Direct Loan program.

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recorded and communicated to management and others who need it, in a form and within a timeframe that enables them to carry out their internal control and other responsibilities.<sup>22</sup> However, although FSA began call monitoring in 2004, it did not summarize the results of its call reviews until September 2014. When we asked FSA officials why there was no earlier documentation of call monitoring results, they said they had always shared results verbally with individual servicers and have only recently begun further formalizing the process, including providing written feedback to individual servicers starting in June 2015. We examined the 11 monthly summary reports, from September 2014 through July 2015, that were available at the time of our review. These reports are used for FSA management purposes and summarize results from all servicers, and we found they lacked some key information. For example, one month's summary did not include the total number of calls monitored or the number of calls that did not pass the review. Furthermore, report information sometimes appeared inaccurate or conflicted from month to month. For example, the January 2015 report notes that 10 percent of calls that did not pass review had forbearance issues (such as the representative not properly qualifying a borrower for forbearance), and noted that this is a decrease from previous months.<sup>23</sup> However, the November 2014 and December 2014 reports do not list forbearance as a reason calls did not pass the review, and as a consequence, any decrease cannot be confirmed through FSA's reports.

In addition, the monthly summary reports do not capture the full extent of specific problems, because they only focus on issues that surface in calls that do not pass the review. FSA officials said the database used to record its call monitoring results automatically designates a call as having failed the review when the reviewer notes four or more errors. These errors can range from breaches of etiquette — such as the customer service representative not conducting the call in a pleasant manner — to issues of accuracy, such as the representative providing incorrect information about repayment options. Because the monthly summary reports only note the reasons for calls that fail the review, they do not

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<sup>22</sup>GAO, *Standards for Internal Control in the Federal Government*, GAO-AIMD-00-21.3.1 (Washington, D.C.: November 1999).

<sup>23</sup>Forbearance is a temporary postponement, extension, or reduction of loan payments for up to 12 months that is authorized when a borrower cannot make scheduled payments for certain reasons, such as financial hardship.

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reflect issues that occur in calls with 3 or fewer errors. For example, if a customer service representative fails to answer all of a borrower's questions, but does not compound this problem with 3 additional errors in the same call, the summary report does not capture this information. Standards for Internal Control in the Federal Government state that internal control monitoring should assess the quality of performance over time. Because not all errors identified in call monitoring are captured in FSA's monthly reports, the reports do not reflect the actual prevalence of particular problems in the calls the agency monitors, and consequently, are insufficient for FSA to analyze the results of its call monitoring over time to inform its management activities. FSA officials said they are aware of the issues with the summary reports and are working to improve their accuracy, consistency, and utility for managers.

FSA's monitoring of servicer phone calls is designed to assist the agency in meeting its goal of providing superior service and information to borrowers, by providing a direct opportunity to monitor how servicers interact with borrowers. However, without a systematic approach to conducting reviews of both inbound and outbound calls and documenting the results of all call reviews, FSA is missing opportunities to target its oversight and improve services to borrowers.

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## FSA Has Taken Some Steps to Improve Oversight of Loan Rehabilitation

FSA has taken some steps to improve its oversight of loan rehabilitation in response to our March 2014 report.<sup>24</sup> In March 2014, we found that, because of limited planning and oversight, FSA was unable to provide most borrowers who completed loan rehabilitation with timely benefits for more than a year following the October 2011 upgrade of its defaulted loan information system. As a result, borrowers who made a good faith effort to rehabilitate their loans experienced delays in having the defaults removed from their credit reports and reinstating their federal student aid eligibility.

As of March 2014, FSA reported that the original information system, which had been in place since 1989, had become costly to maintain and many manual workarounds had been developed over the years to address emerging requirements. FSA officials said it was also necessary to upgrade the system to handle the increased loan volume that the office

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<sup>24</sup>[GAO-14-256](#)

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

**Table 1: Risk Factors Associated with the Defaulted Student Loan System Upgrade, as of March 2014**

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

Source: GAO analysis of FSA documentation. | GAO-16-196T

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

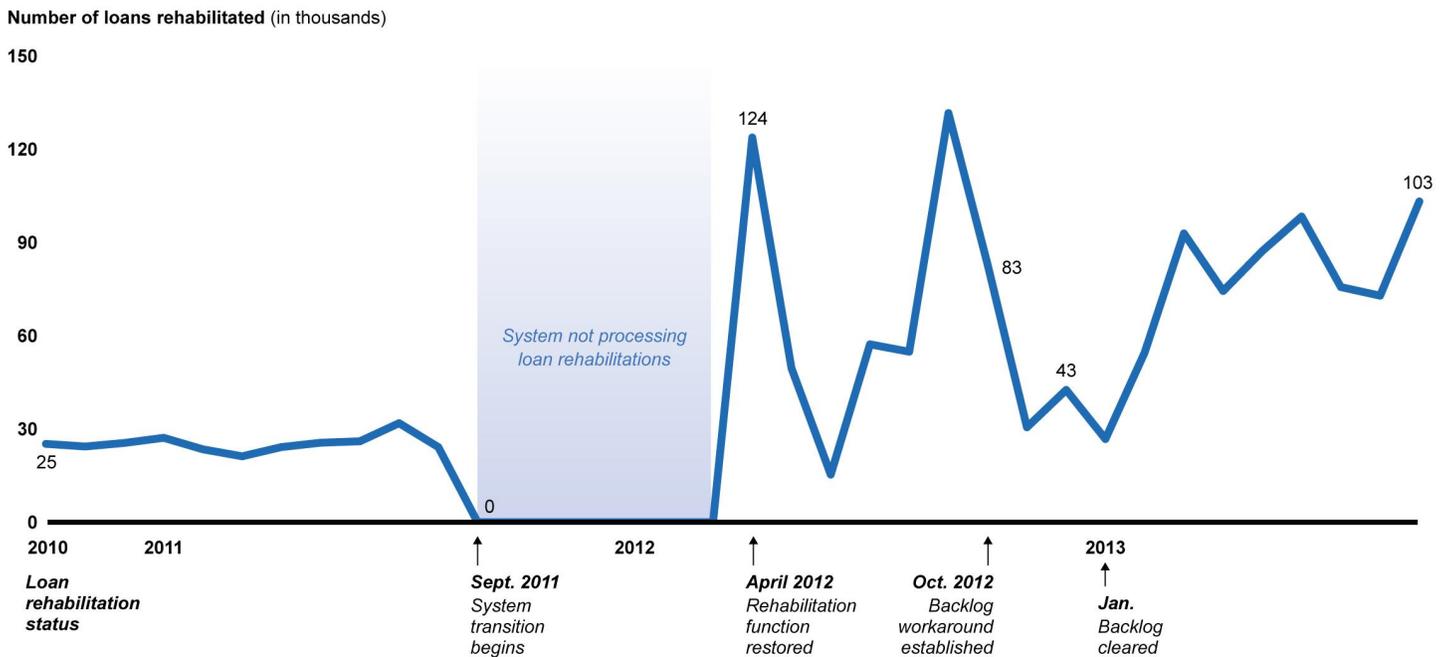
<sup>a</sup>A cure notice informs the contractor that the government considers the contractor's failure to make progress as endangering performance of the contract, or the contractor has failed to perform contractual provisions other than delivery of supplies or performance of services. The cure notice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

Despite these risks, in March 2014, we reported that FSA did not have plans in place for monitoring the upgrade, and we found limited evidence of oversight conducted. For example, FSA had not updated its monitoring plan for the system contract until about a year after the upgrade work began and performance problems, such as missed deadlines, had occurred. FSA officials also acknowledged that they had not documented many of their monitoring activities. Moreover, we found FSA's testing of the new information system, which began in February 2011, was insufficient to detect problems associated with loan rehabilitation. For example, FSA had not learned until shortly after the launch that the system did not recognize when borrowers had made nine on-time payments in 10 months because it had not tested this function. Officials

explained that testing in a 7-month time frame did not allow loan rehabilitation to be fully tested.

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

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



Source: GAO summary of Office of Federal Student Aid (FSA) data. | GAO-16-196T

As we previously reported, soon after the upgrade began, FSA worked with the contractor to identify and correct the problems and took some steps to hold the contractor accountable and assist borrowers.

- Efforts to hold the contractor accountable.** While the system upgrade was completed at no additional cost to the government, the contractor also provided other services under the contract, such as loan servicing and providing FSA with access to its data centers. In September 2011, FSA began assessing the contractor financial penalties due to implementation delays. In February 2012, when the problems were still not resolved, FSA notified the contractor via a cure notice that it could default on the contract unless adequate progress

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was made on the upgrade issues.<sup>25</sup> In November 2013, FSA reported withholding approximately \$14 million from total payments to the contractor for other services provided under the contract.

- **Efforts to assist borrowers.** FSA established procedures in November 2011 to assist eligible borrowers by removing defaults from their credit reports or reinstating their eligibility for student aid. However, borrowers had to contact the department or their collection agency to receive the assistance.<sup>26</sup>

As we reported in March 2014, when FSA's upgraded information system began processing loan rehabilitations in April 2012, the system still did not always recognize that eligible accounts had satisfied the requirements for loan rehabilitation. As a result, FSA had to implement system workarounds and begin manually processing loan rehabilitations. While FSA officials reported they stopped using manual processing in September 2013, they acknowledged that the system still required workarounds and a substantial amount of development work was needed to address remaining issues. At the time of our March 2014 report, FSA expected the work to be completed under a new contract, which was awarded in September 2013.

To strengthen FSA's oversight of the defaulted student loan information system contract, in our March 2014 report we recommended that FSA take steps to ensure that the final monitoring plan for the new contract identified risks and the oversight activities planned to address them. FSA agreed with the recommendation and reported that it has developed a contract monitoring plan that tracks explicit deliverables related to key risk areas and is using a management approach that includes risk monitoring and mitigation strategies. FSA also reported working with an independent verification and validation service to ensure that the new system

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<sup>25</sup>A cure notice informs the contractor that the government considers the contractor's failure to make progress as endangering performance of the contract, or the contractor has failed to perform contractual provisions other than delivery of supplies or performance of services. The cure notice specifies a period (typically 10 days) for the contractor to remedy the condition. If the condition is not corrected within this period, the cure notice states that the contractor may face termination of its contract for default. 48 C.F.R. § 49.402-3.

<sup>26</sup>FSA officials said they provided such benefits to about 7,600 borrowers—less than 10 percent—of the estimated 80,000 borrowers who were affected during the time the system was not processing rehabilitations. FSA officials said they did not systematically track when assistance was provided, and these rehabilitations were not processed through the system until April 2012 or later.

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contractor establishes the appropriate controls and processes. While these are positive steps, Education's Office of Inspector General recently reported<sup>27</sup> ongoing concerns regarding Education's oversight of the system contract. For example, the Inspector General found that FSA did not update its plan for correcting the defaulted loan information system deficiencies until more than 9 months after the new contract work began, a delay that raises questions about the level of oversight FSA is providing. Accordingly, we will continue to monitor how FSA builds upon and sustains these efforts over time to ensure it is providing appropriate levels of contract oversight.

In March 2014, we also found that FSA lacked data and related performance measures to inform its management and oversight of loan rehabilitation. According to FSA's Fiscal Year 2011-2015 Strategic Plan, Education needs to be able to collect, analyze, and use customer data to achieve its goals of providing superior service and information to students and ensuring program integrity and safeguarding taxpayers' interests. Even though FSA was able to track the number of loans being rehabilitated during the system transition, it had not developed performance data to assess the number or extent of individual borrower delays, or the extent to which borrowers who rehabilitate their loans stay out of default. To address this issue, we recommended that FSA develop an approach for tracking loan rehabilitation performance. FSA agreed with the recommendation and reported that it had developed reports to track whether eligible borrowers had actually completed the loan rehabilitation process, and a June 2015 analysis showed all loans were being rehabilitated successfully within one week of becoming eligible. While this is a positive step, we are awaiting additional information from FSA regarding its methodology and the steps it has taken to ensure they fully address rehabilitation process issues.

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## Conclusions

Education's Office of Federal Student Aid faces challenges in the management of the Direct Loan program that affect its ability to function effectively as a performance-based organization. If the agency fails to strengthen its instructions and guidance to servicers, there will continue to be areas of inconsistent implementation, and differences between servicers could have financial consequences that hurt borrowers or risk

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<sup>27</sup>U.S. Department of Education, Office of Inspector General, *Review of Debt Management Collection System 2 (DMCS2) Implementation*, ED-OIG/A04N0004, August 24, 2015. See also, U.S. Department of Education, Office of Inspector General, *Functionality of the Debt Management Collection System 2*, ED-OIG/A02N0004, November 5, 2015.

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the integrity of the program. Furthermore, without a robust, systematic process for monitoring and documenting calls between borrowers and servicers, FSA may miss opportunities to ensure program integrity and improve services to borrowers.

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## Recommendations

To strengthen management of the Direct Loan Program and ensure good customer service for borrowers, we recommend the Secretary of Education direct the Office of Federal Student Aid's Chief Operating Officer to take the following three actions:

1. Review its methods of providing instructions and guidance to servicers, identifying areas to improve clarity and sufficiency, and ensure consistent delivery of instructions and guidance to ensure program integrity and improve service to borrowers. For example, the Department could consider implementing a detailed, common servicing manual for the Direct Loan program.
2. Implement a more rigorous methodology for selecting recorded calls between servicers and borrowers to review, including a clearer definition of the sample servicers should select, a sample that targets more critical and more frequent types of calls, and a verification process to ensure integrity of the call selection process.
3. Better document call monitoring results to allow analysis of trends over time and facilitate the sharing of complete and consistent information from these efforts with FSA management.

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Chairman Meadows and Chairwoman Foxx, Ranking Members Connolly and Hinojosa, this completes my prepared statement. I would be pleased to respond to any questions that you may have at this time.

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## GAO Contacts and Staff Acknowledgments

If you or your staff have any questions about this testimony, please contact me at (617) 788-0534 or [emreyarrasm@gao.gov](mailto:emreyarrasm@gao.gov). Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this statement. Key contributors to this testimony were Kris Nguyen (Assistant Director), Kristy Kennedy, Timothy Shaw, Mark Ward, and Rebecca Woiwode. Providing legal or technical assistance were James Bennett, Jessica Botsford, Jean McSween, and Charlie Willson. For contributors to our report on defaulted loan rehabilitation, see [GAO-14-256](#).

# Appendix I: Accessible Data

## Data Tables

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

<b>Year</b>	<b>Month</b>	<b>Number of loans rehabilitated (in thousands)</b>	<b>Loan rehabilitation status</b>
2010	Oct.	25208	N/A
	Nov.	24370	N/A
	Dec.	25511	N/A
2011	Jan.	27166	N/A
	Feb.	23458	N/A
	March	21214	N/A
	April	24180	N/A
	May	25578	N/A
	June	26041	N/A
	July	31867	N/A
	Aug.	24165	N/A
	Sept.	0	System transition begins.
	Oct.	0	N/A
	Nov.	0	N/A
	Dec.	0	N/A
2012	Jan.	0	N/A
	Feb.	0	N/A
	March	0	N/A
	April	123783	Rehabilitation function restored
	May	49539	N/A
	June	15315	N/A
	July	57242	N/A
	Aug.	54864	N/A
	Sept.	131643	N/A
	Oct.	82780	Backlog workaround established
	Nov.	30549	N/A
	Dec.	42581	N/A
2013	Jan.	26757	Backlog cleared
	Feb.	54615	N/A
	March	92923	N/A
	April	74379	N/A
	April	87269	N/A
	May	98347	N/A
	June	75661	N/A

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<b>Year</b>	<b>Month</b>	<b>Number of loans rehabilitated (in thousands)</b>	<b>Loan rehabilitation status</b>
	July	72891	N/A
	Aug	103213	N/A

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Source: GAO summary of Office of Federal Student Aid (FSA) data. |  
GAO-16-196T

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