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REPORT TO THE CONGRESS

Opportunity To Reduce Federal Interest Costs By Changing Loan Disbursement Procedures Under The Guaranteed Student Loan Program

B-164031(1)

Office of Education

Department of Health, Education, and Welfare

BY THE COMPTROLLER GENERAL OF THE UNITED STATES

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APRIL 20, 1970

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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D C 20548

B-164031(1)

To the President of the Senate and the
Speaker of the House of Representatives

This is our report on the opportunity to reduce Federal interest costs by changing loan disbursement procedures under the Guaranteed Student Loan program administered by the Office of Education, Department of Health, Education, and Welfare. This program is authorized by title IV, part B, of the Higher Education Act of 1965 (20 U.S.C 1071). Our review was made pursuant to the Budget and Accounting Act, 1921 (31 U S.C. 53), and the Accounting and Auditing Act of 1950 (31 U S C 67)

Copies of this report are being sent to the Director, Bureau of the Budget; the Secretary of the Treasury; the Secretary of Health, Education, and Welfare; and the Commissioner of Education.

Elmer B. Staats

Comptroller General
of the United States

ABBREVIATIONS

GAO	General Accounting Office
GSL	Guaranteed Student Loan program
HEW	Department of Health, Education, and Welfare

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Office of Education
Department of Health, Education, and Welfare B-164031(1)

D I G E S T

WHY THE REVIEW WAS MADE

The Guaranteed Student Loan program, established in 1965, is administered by the Office of Education, Department of Health, Education, and Welfare (HEW) The program is made up of two components--a State or private nonprofit agency loan insurance program and a Federal loan insurance program.

Students attending colleges, universities, or vocational schools can obtain long-term loans from a bank, credit union, savings and loan association, or any other lender participating in the program. The Government usually pays the interest charged on these loans while the students are in school and during a grace period afterwards.

The loans are insured either by a State or private nonprofit agency or by the Government under the Federal Insured Student Loan program when students or lenders do not have reasonable access to a State or private nonprofit loan insurance program.

The Government bears all the losses for defaulted federally insured loans and a large portion of the losses for defaulted State or privately insured loans.

From inception of the Guaranteed Student Loan program through fiscal year 1969, about 1,681,000 loans amounting to more than $1 4 billion were insured. (See p. 8.)

Because of the rapid growth of the program, the General Accounting Office (GAO) examined lenders' loan disbursement practices and their effect on the cost to the Government.

FINDINGS AND CONCLUSIONS

The Government's costs for interest payments made to lending institutions on student loans totaled $44.2 million through December 1968.

(See p. 8.) Interest costs on future loans can be reduced significantly if the Office of Education effectively arranges for lenders to disburse loans in installments when the funds are intended for use in more than one academic period, such as a semester or quarter. (See p. 9.)

From a statistical sampling of loan disbursements, GAO estimated that, from November 1965 through December 1968, the Government's interest costs would have been about $8.9 million less if the lenders had been required to disburse students' loans at the beginning of each period of the school year for which the funds were required. (See pp. 9 to 13.)

The Office of Education did not have statistical data available on the percentage of students annual academic expenses incurred during each term of a school year GAO assumed for illustrative purposes that equal portions of the loan proceeds would be needed for each academic semester or period. Where a larger portion of the loan proceeds in GAO's sample cases would have been needed in the first academic period, the estimated additional interest costs would have been less. (See pp 12 and 13.)

The law does not specify when loans should be disbursed to students. However, during March 1969 hearings before the Special Subcommittee on Education, House Committee on Education and Labor, the Subcommittee Chairman stated that it was the original intent of the Congress that disbursements of loans be made on an installment basis. (See p. 9.)

GAO noted several cases where students received loans in lump-sum payments during the first academic period covered by the loans but did not remain eligible for the portions of the loans intended for use in later periods. Thus, the lenders have larger loan balances to collect than they would have had if the loan disbursements had been limited to needs for the immediate term. Also, the potential cost to the Government for defaulted loans is increased correspondingly. (See pp. 18 to 20.)

During GAO's review, the Office of Education issued instructions to encourage lenders participating in the program to disburse loans in installments where appropriate GAO's review of a random sample of loans made since the instructions were issued showed that a significant number of lenders were continuing to disburse loans in lump sums. (See pp. 21 to 23.)

Representatives of several lending institutions said that multiple disbursements of loans added somewhat to their costs, but they could not provide GAO with an estimate. GAO recognizes that lenders might incur some additional administrative costs but believes that loans should be disbursed in installments wherever practicable in view of the significant potential savings in Government costs. (See pp 16, 17, and 24.)

RECOMMENDATIONS OR SUGGESTIONS

The Secretary, HEW, should effectively arrange for lending institutions to disburse student loans on an installment basis when the funds are for use in more than one academic period. (See p. 25.)

AGENCY ACTIONS AND UNRESOLVED ISSUES

HEW agreed that multiple disbursements of loans made under the program would result in interest savings to the Government. Federal regulations are to be amended to provide that lenders may disburse student loans in such installments as are deemed appropriate by the lenders with the exception that the funds disbursed during a given semester, quarter, or term are not to be greater than the amounts required by the students for that academic period. (See p. 25.)

MATTERS FOR CONSIDERATION BY THE CONGRESS

GAO is reporting this matter to the Congress because of the expressed interest of congressional committees in the increasing growth, and attendant Federal costs, of the Guaranteed Student Loan program.

CHAPTER 1

INTRODUCTION

The General Accounting Office has reviewed certain aspects of the administration by the Office of Education, Department of Health, Education, and Welfare, of the Guaranteed Student Loan program established pursuant to title IV, part B, of the Higher Education Act of 1965, as amended (20 U.S.C. 1071). This program is comprised of two components--a State or private nonprofit agency[1] loan insurance program and a Federal loan insurance program.

Title IV, part B, of the Higher Education Act of 1965, as amended, authorizes the Commissioner of Education to (1) encourage States and private nonprofit institutions and organizations to establish adequate loan insurance programs for students in institutions of higher education and vocational schools, (2) provide a Federal program of student loan insurance for students or lenders who do not have reasonable access to a State or private nonprofit program of student loan insurance, (3) pay, on behalf of qualified students, a portion of the interest charged by lending institutions on loans which are insured under either the Federal program or eligible loan insurance programs established by State or private nonprofit institutions, and (4) guarantee a portion of each loan insured under an eligible loan insurance program established by a State or a private nonprofit institution.

Our review was primarily concerned with the aspect of the Guaranteed Student Loan program under which the Government pays lending institutions, on behalf of qualified students and for specified periods of time, the interest on

[1]A private nonprofit agency is a school, organization, institution, or other agency, owned and operated by one or more nonprofit corporations or associations that cannot use net earnings to benefit any private shareholders or individuals.

student loans which are insured either by the Government or by a State or private nonprofit agency. We did not make an overall evaluation of the administration of the program. The scope of our review is described on page 26 of this report.

PROGRAM OPERATION

At the time the Higher Education Act was approved in 1965, 17 States had independent agencies which administered student loan insurance programs at the State level. After the act was approved, either a State or private nonprofit student loan insurance program was established in the remaining 33 States.

During 1967 the Office of Education implemented the Federal Insured Student Loan program, hereinafter referred to as the Federal program, because the demand for student loans exceeded the amount of funds available for insuring loans at the State level. The Federal program was first used in August 1967. As of June 30, 1969, 26 States were participating in the Federal program.

Under the Guaranteed Student Loan (GSL) program, a student borrows money directly from a bank, credit union, savings and loan association, or any other participating lender, and the loan is insured either by the Government or by a State or private nonprofit agency. The student may obtain a loan application from a participating lender, school, State or private guaranty agency, or the Office of Education regional office. The student completes and forwards the loan application to the educational institution that he will be attending during the period to be covered by the requested loan.

The educational institution certifies the student's loan application to show (1) that he is enrolled or has been accepted for enrollment, (2) that he is in good academic standing, (3) that his estimated college expenses are reasonable, and (4) the amount of other financial aid made available by or through the institution. In addition, the institution indicates on the application the portion of the requested loan required to meet the student's immediate educational expenses.

The educational institution or the student then submits the application to the lender selected by the student for the lender's consideration as to whether to make the loan and as to what amount. If the lender agrees to make the loan, he submits the application to the appropriate State or private guaranty agency for endorsement so that the loan can be guaranteed or, with respect to the Federal program, to the appropriate Office of Education regional office so that the application can be approved for insurance.

The maximum amount of the loans made to a student in any single academic year, or its equivalent, that may be insured under the GSL program is $1,500. The aggregate unpaid principal amount of all such insured loans made to any student may not at any time exceed $7,500.

In 1965, when the GSL program was established, the maximum rate of interest that could be charged by lenders on student loans was 6 percent a year on the unpaid principal balance of the loan. Public Law 90-460, approved August 3, 1968, increased the maximum rate of interest to 7 percent a year. Public Law 90-460 also authorizes the Office of Education to enter into agreements with State and private guaranty agencies providing for their reimbursement for 80 percent of their losses resulting from a student's default of a loan or from the nonpayment of a loan due to the death or disability of a student borrower. Public Law 90-575, approved October 16, 1968, increased the amount of the reimbursement for losses attributable to the death or disability of a student borrower to 100 percent.

Students who obtain loans that are insured under either the Federal program or the State or private program are eligible to have paid on their behalf, by the Government, a portion of the interest on their loans if the combined adjusted gross income of the student (and his parents and spouse, if applicable) as reported for Federal tax purposes for the preceding year, less 10 percent and amounts allowable for exemptions, was less than $15,000. Office of Education statistics show that the vast majority of the student borrowers qualify for interest benefits under the income limitation.

The Government pays all the interest on eligible student loans during the period the students are in school; during the grace period (about 9 to 12 months after the students leave school); and during periods when repayment is deferred for students serving in the Armed Forces, Peace Corps, or Volunteers in Service to America. After the grace period a student is required to repay the loan plus interest over a maximum period of 10 years, exclusive of any deferment period. On loans made prior to the Higher Education Amendments of 1968, the Government also pays 3 percent interest during the repayment period and the student pays the balance.

The Emergency Insured Student Loan Act of 1969 (Public Law 91-95, approved October 22, 1969) authorizes the payment of a special allowance by the Government, in addition to the interest payments made by the Government on behalf of eligible students, to lenders participating in the GSL program whenever existing economic or money market conditions are impeding or threatening to impede the carrying out of the purposes of the program and are causing the return to lenders to be less than equitable. The authorized allowance cannot exceed 3 percent a year of the average quarterly unpaid principal balance of loans made under the GSL program on or after August 1, 1969.

A Federal regulation (45 CFR 177.4), issued by the Commissioner of Education in October 1969, authorized a special allowance to be paid to participating lending institutions for the period August 1, 1969, through September 30, 1969, in an amount equal to 2 percent a year of the average unpaid principal balance of eligible loans outstanding during the period. The special allowance was increased to 2-1/4 percent for the quarter ending December 31, 1969.

LOAN ACTIVITY

Following is a summary of the loan activity under the GSL program for fiscal years 1966 through 1969, as developed by the Office of Education.

	State and private program		Federal program	
	Number of loans	Amount	Number of loans	Amount
Fiscal year 1966	48,495	$ 77,492,058	-	$ -
Fiscal year 1967	330,088	248,494,327	-	-
Fiscal year 1968	432,859	369,293,266	82,549	66,555,455
Fiscal year 1969	538,855	469,069,081	248,489	217,606,700
Total	1,350,297	$1,164,348,732	331,038	$284,162,155

The Higher Education Act of 1965 provides that the Congress will appropriate such sums as are necessary for the payment of interest on loans to qualified students under the GSL program. Through December 1968, the Government had paid various lending institutions about $44.2 million in interest on behalf of qualified student borrowers under the GSL program.

The principal officials of HEW responsible for administration of the activities discussed in this report are listed in appendix II.

CHAPTER 2

OPPORTUNITY TO REDUCE FEDERAL INTEREST

COSTS ON STUDENT LOANS

The Government's costs for interest on student loans obtained under the GSL program could be reduced significantly if the Office of Education effectively arranged for the lenders to disburse loans to students in installments when the funds are intended for use in more than one period (such as a semester or quarter) of a school year. We estimated that, from inception of the GSL program in November 1965 through December 1968, the Government's costs would have been reduced by about $8.9 million had the lenders been required to disburse student loans at the beginning of each period of the school year for which the funds were required.

We also noted several instances where students who had received loans in a lump-sum payment did not maintain their eligibility status throughout the academic periods for which the loans were intended for use. Under such circumstances, lenders are burdened with collecting larger loan balances from students than would be the case had the loan disbursements been geared to the needs of the immediate academic periods. Also, the Government's potential costs for defaulted loans are correspondingly increased.

The legislation governing the GSL program does not specify when loans should be disbursed to students. However, during hearings held before the Special Subcommittee on Education of the House Committee on Education and Labor in March 1969, the Chairman of the Subcommittee stated that it was the original intent of the Congress that disbursements of these loans be made on an installment basis.

Regulations issued by the Commissioner of Education with respect to the National Defense Student Loan program--a direct loan program under which 90 percent of the loan proceeds disbursed to a student borrower represent Federal funds and 10 percent represent non-Federal funds--provide that a school may make a loan to a student borrower in such installments as are deemed appropriate by the school, except that the funds disbursed during a given semester, quarter, or term should not be greater than the amount needed by the student for that academic period. Similar regulations have not been issued with respect to lenders participating in the GSL program.

FEDERALLY INSURED LOANS

Office of Education records of loan disbursements by participating lenders under the federally insured student loan program indicated that it was a common practice for many of the lenders to disburse loans to students in a lump sum at the beginning of the school year rather than in installments at the beginning of each semester or other academic period of the year. This practice was being followed even though the students' applications showed that the funds were intended for use in more than one academic period.

From inception of the Federal program in August 1967 through mid-December 1968, the Office of Education had recorded 151,518 disbursements of federally insured loans, amounting to about $126.6 million. We selected, on a statistical-sampling basis, 264 of these loan disbursements as a basis for estimating the additional Government interest costs that had been incurred as a result of the practice of lenders' disbursing loans in a lump sum rather than in installments at the beginning of each academic period for which the funds were needed.

The Office of Education records showed that, of the 264 loan disbursements, 182 (about 69 percent) represented loans that had been disbursed in lump-sum payments before or during the first academic period covered by the loans although the students' applications indicated that the funds were needed for more than one academic period.

We computed the additional interest cost on each of the 182 student loans for the period between the dates on which the full amounts of the loans were disbursed and the dates on which portions of the loans would have been disbursed to coincide with the periods in which the funds were needed by the students. For the 182 loans, averaging $969 each, the additional interest costs amounted to an average of $10.72 a loan.

Our computation was based on the number of academic periods that each loan was intended to cover according to information shown on the student loan applications. We assumed that, if a loan was intended to cover the entire academic year, equal portions of the loan would be needed in each semester or quarter and that, if the loan also covered a summer session, a smaller portion of the loan would be needed for that period. In determining the approximate number of months that a portion of a loan was disbursed before the funds were needed, we assumed (1) that academic semesters began the first of September and the middle of January, (2) that summer sessions began the first of June, and (3) that academic quarters began the first of September, December, March, and June.

For example, one student applied for and was granted a federally insured loan of $1,000 for use in an academic year consisting of two semesters. The loan, at a 7-percent interest rate, was disbursed in a lump-sum payment on September 3, 1968. Since the loan application did not indicate what portion of the $1,000 was needed for each semester, we assumed that $500 was needed for the fall semester and that $500 was needed for the spring semester. We assumed also that the spring semester began in the middle of January 1969. On these bases, we estimated that the Government incurred additional costs of $11.67 by making interest payments for a 4-month period (September 3 to January 15) on that portion of the loan ($500) that was disbursed approximately 4 months before the beginning of the spring semester for which the funds were needed.

On the basis of our review of the 264 disbursements of student loans in our sample, we estimated that (1) of the 151,518 disbursements of federally insured student loans from inception of the Federal program in August 1967 through mid-December 1968, about 104,500, or 69 percent, represented loans made in lump-sum payments even though they were intended for use in more than one period of a school year and (2) the Government's costs would have been reduced by about $1.1 million ($10.72 for each of the 104,500 loans) had the loans been disbursed at the beginning of each period for which the funds were required rather than in a lump sum before or during the first academic period covered by the loans.

LOANS GUARANTEED BY STATE AND PRIVATE AGENCIES

Inasmuch as the lenders participating in the Federal program generally had participated in the State or private program before the Federal program was implemented, we believe it likely that their disbursement practices under both programs were similar. In this respect, the rules and regulations submitted to the Office of Education by State and private agencies, in requesting approval for participation in the GSL program, showed that only three States (Arkansas, North Carolina, and Louisiana) required lending institutions to disburse loans in multiple payments when they were intended for use in more than one academic period. Moreover, an Office of Education official, in commenting to HEW's Office of General Counsel on the Higher Education Amendments of 1968, stated that an estimated 90 to 95 percent of all the loans under the GSL program were being made in single disbursements.

The Office of Education furnished us statistical information which showed that, from inception of the GSL program in November 1965 through December 1968, lenders of State and privately insured student loans had made 1,052,000 disbursements totaling about $813 million. However, because the Office of Education could not furnish information pertaining to the periods for which the loans were provided, we could not estimate, in the manner that we did for loans under the Federal program, the Government's additional costs that might have been incurred as a result of lenders' disbursing State or privately insured loans in lump-sum payments when the loans were intended for use in more than one academic period.

If the results developed in our statistical sample of loan disbursements under the Federal program held true for the State or private program, we estimate that (1) about 725,900 disbursements (69 percent of 1,052,000 disbursements) represented loans made in single lump-sum payments even though they were for use in more than one academic period and (2) the additional interest costs on these loans amounted to about $7.8 million ($10.72 for each of the 725,900 loans).

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The Assistant Secretary, Comptroller, HEW, by letter dated February 24, 1970, stated that, although HEW agreed that loan funds should not be disbursed to a student until required for educational costs, HEW did not believe that a loan for a school year should be disbursed proportionately to the number of terms in the year. He stated further that the allocation of a fixed percentage of the loan for each semester would create problems for the student and his family because such an allocation would not take into consideration the educational costs which the student must meet at given times of the year.

We did not intend to imply that the amount of a loan for a school year be disbursed to the student in equal portions for each term of the year but rather that the amounts disbursed be directly related to his needs for individual academic periods. However, because the Office of Education did not have statistical data available as to the percentage of a student's annual academic expenses incurred during the several terms of a school year, we assumed, for illustrative purposes, that equal portions of the loan proceeds would be needed for each academic semester or period.

Our estimate of the Government's additional costs that were incurred as a result of lenders disbursing student loans in lump sums where installment payments would have been appropriate (about $8.9 million) is intended to demonstrate that an opportunity exists to reduce such interest costs by changing the loan disbursement practices. If we had based our estimates on the assumption that the students needed 10 percent more of their total loan amounts in the first period than in subsequent periods covered by their loans, our estimate of the Government's additional costs would have been reduced to about $7.1 million.

REACTIONS OF STATE GUARANTY AGENCIES AND LENDERS PARTICIPATING IN THE GSL PROGRAM

During our review we visited the State guaranty agencies in Arkansas, California, and Louisiana and inquired into the manner in which student loans were being disbursed under the GSL program. We also discussed disbursement practices with representatives of a number of the principal lending institutions participating in the program in the three States.

The directors of the Arkansas and Louisiana guaranty agencies informed us that lenders participating in their programs generally are required to disburse loans to students in two equal installments where the loans are for use in an academic year consisting of two semesters--one disbursement at the beginning of each semester. Where the academic year consists of three quarters, one disbursement is required at the beginning of the fall quarter to cover student educational expenses for the fall and winter quarters, and the other disbursement at the beginning of the spring quarter to cover the expenses for that quarter.

We were further informed that lenders in Arkansas are allowed to disburse loans in single lump-sum payments to vocational students who pay all of their school year fees and other educational expenses at the beginning of the academic training period.

The director of the Louisiana agency stated that the multiple loan disbursement requirement was initially imposed on lenders who participated in the State's student loan insurance program before the GSL program was established in 1965. He pointed out that the State, which was then responsible for making interest payments on student loans during the in-school period, had recognized that interest costs for about 4-1/2 months could be saved on that portion of a loan that was not disbursed until the beginning of the second academic semester.

The director of the Arkansas agency told us that, before December 1968, the agency purchased life insurance on students who obtained loans under the GSL program and that the monthly cost of such insurance was based on a student's outstanding loan balance. He also stated that, by requiring lenders to disburse loans in installments, insurance costs for about 4-1/2 months were saved on the portion of a loan that was not disbursed until the beginning of the second academic semester.

Both the Arkansas and Louisiana directors also said that requiring lenders to make multiple disbursements of loans covering a full school year (1) assures that students will have funds for the second semester, (2) precludes students who do not enroll for a second semester from obtaining funds for that semester, and (3) provides more assurance that loan funds will be used for academic purposes.

The director of the California guaranty agency informed us that, when the State student loan insurance program was implemented in 1966, lenders were required to make multiple disbursements of student loans that covered more than one academic semester, quarter, or term. He stated, however, that, shortly after the program got underway, certain participating banks indicated a desire to disburse the full amount of a loan at one time and that, as a result, the agency asked the members of its advisory committee for their opinions regarding such a change in loan disbursement practices.

The director stated further that, because some of the members favored discontinuance of multiple loan disbursements while others favored multiple disbursements, the agency, in December 1966, made the method of disbursement optional to the lenders for the remainder of the 1966-67 academic year and, subsequently, made it optional for the 1967-68 academic year. The director also informed us that the State agency discontinued insuring new loans in November 1967 because the demand for student loans exceeded the amount of funds available for insuring loans under the agency's program. The Federal program began operating in the State in December 1967.

We examined the replies of the 14 members of the State guaranty advisory committee who had commented on the lenders' requests to make single lump-sum loan disbursements. Some of the replies indicated that single lump-sum disbursements would reduce lenders' administrative paperwork and the costs involved in handling the loans. Other replies indicated that multiple disbursements should be continued so that students would be assured of having funds available to help meet their educational expenses during the second academic semester. One reply pointed out that the additional work involved in filing an interest subsidy application for each loan disbursement was better than incurring avoidable losses that result from having made maximum disbursements at the beginning of the academic year to students who do not return for succeeding semesters or quarters.

During January and February 1969, we met with representatives of eight of the principal lending institutions participating in the GSL program in Arkansas and Louisiana, where multiple disbursements of loans are required, and with representatives of seven of the principal lending institutions participating in the GSL program in California, where multiple disbursements are optional.

The representatives of Arkansas and Louisiana lending institutions informed us that they were in agreement with the multiple loan disbursement requirement because they believed that it (1) prevented students from obtaining a loan for a school year when, for some reason, they might decide not to enroll for the second semester, (2) assisted students in the management of their funds, and (3) provided better assurance that the loan funds would be used for educational purposes. The lenders expressed the opinion that multiple disbursements of loans added somewhat to their costs but stated that they could not provide us with an estimate of what the additional costs might be.

Of the seven principal California lending institutions, six were making disbursements of student loans under the Federal program in single lump-sum payments and one was making disbursements on an installment basis to certain freshmen and sophomores and in single lump-sum payments to juniors and seniors. We were informed that this lender felt that the use of the latter practice avoided making funds available to those students who were more likely to withdraw from school and recognized that the older, more mature students were better able to manage their funds.

The representatives of the California lending institutions generally expressed the view that multiple disbursements of loans would be somewhat more costly than single disbursements but that there were advantages to be gained from adopting a multiple disbursement policy. However, as in the case of the Arkansas and Louisiana lenders, they stated that they could not provide us with an estimate of the relative costs of disbursing loans on a single and a multiple payment basis.

ADMINISTRATIVE PROBLEMS ASSOCIATED WITH LOAN DISBURSEMENTS FOR NEEDS BEYOND THE IMMEDIATE ACADEMIC PERIOD

The Higher Education Act of 1965 requires that, to be eligible for financial aid under the GSL program, a student must be in good academic standing, must be enrolled at least half time, and must use the aid for educational purposes. When students fail to meet the enrollment requirement throughout the academic periods for which loans are provided, they are required to repay the outstanding loan balance commencing 9 to 12 months after they leave school or cease to carry the prescribed academic workload.

Because lenders disbursed loans to certain students in lump-sum payments in situations where multiple disbursements would have been appropriate and the students did not maintain their eligibility status throughout the academic periods for which the loans were intended to be used, lenders had larger loan balances to collect than would have been the case had the loan disbursements been limited to the needs of the immediate academic period. In such instances the potential cost to the Government for defaulted loans is correspondingly increased.

In our tests at four educational institutions in California, we noted that nine students had received loans in a lump-sum payment during the first academic period covered by the loans but did not maintain eligibility for the portions of the loans that were intended for use during later academic periods. Five of these students did not register for one or more academic periods covered by their loans, three did not register for sufficient study units to qualify for a loan in academic periods subsequent to the period in which the loan was disbursed, and one did not register for sufficient units to qualify for a loan in the second academic period and did not register for the third period covered by his loan.

The nine students had received loans totaling $8,170 for the periods involved. Because the students subsequently did not meet the GSL program eligibility requirements, we estimated that loan funds of about $4,200 would not have been disbursed if the loans had been made in installments instead of in lump-sum payments. Since the students' loan applications did not indicate how much of the loan funds would be needed for each academic period covered by the loans, our estimate was based on the assumption that an equal portion of the loans was applicable to each period covered by the loans.

For example, one of the students applied for a $1,000 loan about 6 weeks before the end of the first semester and received the loan funds in a lump sum shortly before the end of that semester. The student's application for the loan indicated that it was to cover the entire academic year consisting of two semesters. The student completed the first semester but failed all courses attempted. He did not register for the second semester and, therefore, was not eligible to receive the portion of the loan that was intended for use in the second semester. We believe that, if a multiple loan disbursement practice had been followed, disbursement of about $500 of the loan could have been avoided.

Another student received a $1,000 loan in a lump-sum payment that was intended to cover the winter, spring, and summer academic quarters. However, the student did not register for sufficient units to qualify for a loan in the spring quarter and did not register for the summer quarter. Had a multiple loan disbursement practice been followed, we believe that a disbursement of about $667 of the loan for the spring and summer quarters could have been avoided. This student subsequently defaulted on his loan and the State guaranty agency reimbursed the lending institution for the unpaid balance. Had the reimbursement arrangement authorized by Public Law 90-460 been in effect at the time the default occurred, the Government would have been responsible for reimbursing the State guaranty agency for 80 percent of its loss.

Another student received a $1,000 loan in a lump-sum payment shortly after the fall semester had gotten under way. The loan was intended to cover the academic year consisting of two semesters. The student completed the fall semester but did not enroll for sufficient study units to qualify for a loan for the spring semester. If a multiple loan disbursement practice had been followed, the student would not have received the portion of the loan that was for use in the spring semester and, we believe, disbursement of about $500 could have been avoided.

The GSL program has not been in operation for a period long enough for the Office of Education to accumulate sufficient data to indicate loan default experience under the program. However, data developed by the Office of Education with respect to loans made to students under the National Defense Student Loan program, a program which has been in operation since 1959, showed that of the aggregate outstanding loan balance of approximately $1.1 billion as of June 30, 1968, about $21.2 million was delinquent as follows:

Period of time loan principal payments were past due as of June 30, 1968	Number of borrowers	Delinquent amount
4 months or less	94,124	$ 6,879,346
6 months	13,347	1,060,695
1 year	34,570	3,439,790
2 years	23,811	3,220,544
3 "	13,751	2,379,182
4 "	8,765	1,832,192
5 "	5,481	1,203,071
Over 5 years	5,269	1,152,009
Total	199,118	$21,166,829

Because the National Defense Student Loan program and the GSL program are similar in many respects, we believe that, in the interest of minimizing the Government's potential losses under the GSL program for default of loans by students who do not qualify for loans in periods subsequent to the period in which the loans are disbursed, every effort should be made to disburse loans at the beginning of each period for which the funds are needed.

AGENCY ACTIONS TO MINIMIZE FEDERAL EXPENDITURES FOR INTEREST PAYMENTS

In January 1968 the Commissioner of Education issued regulations applicable to the Federal program, which included a provision [stating] that lenders may not disburse any of the proceeds of a federally insured loan to a student borrower any earlier than is reasonably necessary to meet the purposes for which the loan was made. We were informed by an Office of Education official that the intent of this provision was to preclude lenders from disbursing loans to students several months before the beginning of the academic year for which the loans were intended rather than to require lenders to disburse loans in installments that coincide with students' semester or quarter needs.

In discussions with Office of Education officials regarding the policies and practices of lenders in disbursing student loans under the GSL program, we pointed out that the Government was incurring additional interest costs because lenders were disbursing student loans in lump-sum payments before or at the beginning of the academic year even though the loans were purported to be needed for more than one academic period.

The Office of Education subsequently issued a memorandum dated April 25, 1969, to all State and private guaranty agencies, which stated, in part:

> "It has come to our attention that when students obtain a loan prior to or at the beginning of an academic year, lenders frequently advance the entire amount of the loan in a single disbursement even though only a portion of the proceeds may be required immediately to defray expenses for the ensuing semester or other academic period. This procedure may have a number of undesirable consequences. Accordingly, we are asking that existing procedures be modified to ensure that only that portion of the loan which is necessary to defray immediate expenses be paid out to the student borrower. Subsequent disbursements may be made as required."

The memorandum stated that, to accomplish this objective, each guaranty agency should modify that portion of its loan application form which is completed by the educational institution and which each prospective student borrower must present to a lending institution to provide for the inclusion of a statement as to the educational expenses which the student is expected to incur during the first academic semester or period for which the loan funds are needed. The memorandum stated also that the Office of Education anticipated that lending institutions would take such information into consideration in determining the amount of a loan to be disbursed to a student for that portion of the academic year. The memorandum pointed out that the disbursement of student loans in installments would minimize interest payments and result in substantial savings to the Government.

In June 1969, the Office of Education issued a memorandum to all student financial aid officers and other school or college officials concerned with the GSL program requesting them to indicate on a student's loan application, when certifying the student's enrollment in the school or college, the portion of the loan required for the student to meet his immediate educational expenses. The memorandum pointed out that such information could influence lenders, in many cases, to make more than one disbursement of a loan. The memorandum pointed out also that this procedure, which is applicable to both the Federal program and the State or private program, should help to minimize Government expenditures for payments of interest on students' loans as well as to help ensure that student loans would be used only for educational expenses.

As a test of the effectiveness of the Office of Education's instructions in bringing about the disbursement of student loans in installments where appropriate, we reviewed a random sample of 200 of the loan disbursements recorded by the Office of Education under the Federal program since the aforementioned memorandums were issued. Our review showed that 140 disbursements (70 percent) represented loans that were made in a lump-sum payment subsequent to July 31, 1969, even though the loans were intended to cover the students' needs for more than one academic semester or period. It appeared, therefore, that a significant number of lenders were continuing to disburse loans in a single payment even though multiple disbursements would have been appropriate and would have resulted in reducing the Government's expenditures for interest payments as well as in minimizing the potential losses to the Government because of possible loan defaults.

CHAPTER 3

CONCLUSIONS AND RECOMMENDATION

CONCLUSIONS

On the basis of our review, it appears that lenders' lump-sum disbursements of loans to students covering their needs for more than one academic period adversely affects the Government in two ways. First, it results in the Government's payment of interest on a portion of the loans for periods of several months before the time the students need the funds to meet their educational expenses and thus increases the Government's costs. Secondly, it results in the disbursement of loans for academic periods for which the students may not continue to be eligible and thereby increases the potential cost to the Government in case of default of the loans.

It appears also that the disbursement of loans to students before the funds are needed to meet their educational expenses tends to lessen the assurance that funds will be available to meet the expenses when they arise.

We recognize that lenders might incur some additional administrative costs by disbursing loans to students in installments to meet their semester or quarterly needs. We believe, however, that loans should be disbursed in installments wherever practicable in view of the significant potential savings in Government costs.

We estimate, on the basis of our tests, that the practice of disbursing student loans in lump-sum payments where installment payments would have been appropriate has resulted in the Government's incurring additional interest costs of about $8.9 million through December 1968. Under the Emergency Insured Student Loan Act of 1969 (see p. 7), lenders participating in the GSL program may receive special allowances in addition to the maximum interest authorized under the program. Therefore, effective action to bring about installment payments of loans where practicable would result in even greater reductions in program costs.

RECOMMENDATION TO THE SECRETARY OF HEALTH, EDUCATION, AND WELFARE

Inasmuch as prior Office of Education instructions apparently have not minimized the Government's interest costs under the GSL program, we recommend that the Secretary of Health, Education, and Welfare take action to effectively arrange for lending institutions to disburse students' loans on an installment basis when the funds are for use in more than one academic period. Special meetings between college financial aid officers, lending institutions, and State guaranty agencies would, in our opinion, aid in accomplishing this recommendation.

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The Assistant Secretary, Comptroller, HEW, advised us by letter dated February 24, 1970 (app. I), that HEW agreed that a greater reliance on multiple loan disbursements under the GSL program would result in certain savings to the Government and that lenders should be encouraged to make multiple disbursements where feasible and practical.

The Assistant Secretary stated also that HEW plans to amend the Federal regulations covering the GSL program to provide that a lender may disburse a loan to a student borrower in such installments as are deemed appropriate by the lender, except that the funds disbursed during a given academic semester, quarter, or term are not to be greater than the amount required by the student for that academic period.

The Assistant Secretary stated further that HEW would attend as many special meetings with college financial aid officers, lending institutions, and State guaranty agencies as possible within the limitations of its staff.

CHAPTER 4

SCOPE OF REVIEW

Our review was directed toward examining into lending institutions' loan disbursement policies and practices under the GSL program and their effect on the cost to the Government for interest payments made on behalf of qualified student borrowers. We also examined into whether certain students who had received loans under the program continued to be eligible for such funds throughout the academic periods for which the funds were intended for use.

Our review included an examination of applicable legislation and related legislative documents, Federal and State guaranty agency regulations, Office of Education program policies and guidelines, reports, correspondence, and other pertinent documents relating to the GSL program. In addition, we examined (1) loan applications and other records at the Office of Education headquarters relating to 264 randomly selected loan disbursements that had been recorded from inception of the Federal program in August 1967 through mid-December 1968 and (2) loan applications and other records at a lending institution in California relating to a number of additional loan recipients, and academic and other records at the four educational institutions in California where these loan recipients had received or were receiving their education.

Our work was conducted at the Office of Education headquarters in Washington, D.C., and at the aforementioned locations in California. We also discussed the administration of the GSL program with Office of Education regional officials in Dallas, Texas, and San Francisco, California; representatives of the State guaranty agencies in Arkansas, California, and Louisiana; and representatives of 15 of the principal lending institutions participating in the program in the latter three States.

APPENDIXES

DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE
WASHINGTON D C 20201

OFFICE OF THE SECRETARY

FEB 24 1970

Mr. Philip Charam
Associate Director
United States General
Accounting Office
Washington, D.C. 20548

Dear Mr. Charam:

This is in reference to your draft report "Opportunities to Reduce Federal Interest Costs on Disbursements of Loans under the Guaranteed Student Loan Program."

We agree that a greater reliance on multiple disbursements under the Guaranteed Student Loan Program would result in certain savings to the Federal Government. We also agree that lenders should be encouraged to make multiple disbursements where feasible and practical. Therefore, we plan to recommend an amendment to the Federal Regulations covering this program to the effect that: "A lender may make a loan to a student borrower in such installments as are deemed appropriate by the lender, except that the proceeds disbursed during a given semester, quarter or term should not be greater than the amount required by the student for that academic period."

While we agree that funds should not be disbursed until required by the student to pay his educational costs, we do not believe that the total annual loan amount should be disbursed proportionately to the number of terms in the academic year. This procedure fails to consider the educational costs which the student must meet at given times of the year. Rising college costs frequently require a greater amount to be paid in one semester than the student is permitted by law to borrow for the entire year. To allocate a fixed percentage of the loan for each semester would create many personal hardships for the student and his family and will probably result in some students being forced to withdraw from school due to lack of funds.

Page 2 - Mr. Philip Charam

With regard to your recommendation to the Secretary, we welcome all opportunities to hold special meetings with college financial aid officers, lending institutions, and State guarantee agencies. Our current policy is to attend as many such meetings as possible within the limitations of our available staff. It is our intention to continue this policy.

Thank you for the opportunity to review and comment on your proposed report to the Congress.

Sincerely yours,

James F. Kelly

James F. Kelly
Assistant Secretary, Comptroller

PRINCIPAL OFFICIALS OF THE DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE RESPONSIBLE FOR ADMINISTRATION OF THE ACTIVITIES DISCUSSED IN THIS REPORT

	Tenure of office			
	From		To	
SECRETARY OF HEALTH, EDUCATION, AND WELFARE:				
Robert H. Finch	Jan.	1969	Present	
Wilbur J. Cohen	Mar.	1968	Jan.	1969
John W. Gardner	Aug.	1965	Mar.	1968
Anthony J. Celebrezze	July	1962	Aug.	1965
ASSISTANT SECRETARY, DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE, FOR EDUCATION:				
James E. Allen, Jr.	May	1969	Present	
Peter P. Muirhead (acting)	Jan.	1969	May	1969
Lynn M. Bartlett	July	1968	Jan.	1969
Paul A. Miller	July	1966	July	1968
Francis Keppel	Oct.	1965	May	1966
COMMISSIONER OF EDUCATION:				
James E. Allen, Jr.	May	1969	Present	
Peter P. Muirhead (acting)	Jan.	1969	May	1969
Harold Howe, II	Jan.	1966	Dec.	1968
Francis Keppel	Dec.	1962	Jan.	1966

U S GAO Wash , D C