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REPORT BY THE

Comptroller General

OF THE UNITED STATES

Stronger Actions Needed To Recover $730 Million In Defaulted National Direct Student Loans

The National Direct Student Loan program has been plagued by high default rates, resulting in defaulted loans totaling about $730 million.

Schools GAO visited made inadequate efforts to collect defaulted loans. Schools need to adopt a tougher attitude toward collecting defaulted loans, and the Department of Education should take stronger actions against those that fail to do so.

Schools have forwarded to the Department for collection about 240,000 loans with outstanding balances of $215 million. But various problems have slowed the Department's collection efforts. In recent months, collections have doubled; through March 1981 the Department had collected $5.8 million. The Department plans to contract with private collection agencies for future loan collections. Also, to motivate defaulters to pay their debts, the Department will allow credit bureaus to redisclose student loan default data to the general credit industry.

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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON D.C. 20548

B-200138

The Honorable Paul Simon
Chairman, Subcommittee on
Postsecondary Education
Committee on Education and Labor
House of Representatives

Dear Mr. Chairman:

In accordance with arrangements made with your office, we are reporting on (1) the Department of Education's National Direct Student Loan program and (2) a recent decision by the Department to contract with private agencies for the collection of defaulted student loans. The report contains recommendations to the Secretary of Education to strengthen the management of the program and improve loan collections.

As arranged with your office, we are sending copies of this report to the Secretary of Education and plan no further distribution of this report until 5 days from its issue date. At that time we will send copies to interested parties and make copies available to others upon request.

Sincerely yours,

Milton J. Socolar

Acting Comptroller General
of the United States

COMPTROLLER GENERAL'S REPORT
TO THE CHAIRMAN, SUBCOMMITTEE
ON POSTSECONDARY EDUCATION,
HOUSE COMMITTEE ON EDUCATION
AND LABOR

STRONGER ACTIONS NEEDED TO RECOVER $730 MILLION IN DEFAULTED NATIONAL DIRECT STUDENT LOANS

D I G E S T

Since the National Direct Student Loan program began in 1958, nearly $5 billion in Federal funds have supported loans to about 11 million students. These loans are made from revolving funds maintained by participating schools, which are responsible for making loans and collecting repayments. The Federal Government provides 90 percent of the moneys for the revolving funds, while the schools provide 10 percent. The Department of Education estimates that, for the 1980-81 school year, about 870,000 students received loans at some 3,100 participating institutions.

The program has been plagued by high default rates--16.04 percent as of June 30, 1979, the latest date for which data were available. As of that date outstanding defaulted loan balances exceeded $730 million, an increase of about $29.2 million from the previous year. Nearly 1,200 schools had default rates of 20 percent or higher; 315 schools had default rates exceeding 41 percent. (See pp. 1 and 2.)

GAO's review focused on determining how well schools were carrying out their responsibilities for administering and collecting student loans and identifying Department of Education actions for collecting defaulted loans forwarded to it by participating schools. GAO intended to identify factors that have affected student loan collections at participating schools and have hampered the Department's collection efforts. GAO believes that stronger collection efforts are needed by participating schools. The Department's collection activities also have been inadequate; however, its performance has improved.

GAO visited seven schools in the Midwest with default rates ranging from 5.9 to 63.1 percent and obtained information on 599 defaulted loans. Six of these schools had default rates exceeding 20 percent. The seven schools were judgmentally

selected; therefore, the observations on loan collection procedures relate only to these schools. GAO also obtained information on defaults and collections for 33 other schools in the same geographical area with default rates exceeding 20 percent. (See pp. 3 and 4.)

SCHOOLS NEED TO IMPROVE LOAN ADMINISTRATION AND COLLECTION PROCEDURES

Nearly 19 years after program inception, the Department of Education developed interim program regulations requiring schools to be diligent and forceful in administering and collecting student loans. These and later regulations require schools to inform borrowers of their rights and obligations, attempt to collect from defaulted borrowers by using their own personnel or commercial collection agencies, and sue defaulted borrowers under certain conditions. Many of these procedures were recommended for use by participating schools before the interim regulations were issued. (See p. 2.)

The seven schools GAO visited did not fully comply with the Department of Education's loan collection procedures. Though they generally did an adequate job sending bills and collection letters, improvements should be made in other areas. (See p. 6.) For example:

--Some schools were remiss in counseling borrowers and maintaining contact with them. (See p. 6.)

--Most of the schools had problems locating borrowers with whom they had lost contact. (See p. 8.)

--Schools often did not refer accounts quickly to collection agencies, monitor the status of accounts referred, and determine the collection agencies' success. (See p. 9.)

--The seven schools had been reluctant to sue borrowers to collect defaulted loans. (See p. 11.)

Several school officials believed that referring names of defaulted borrowers to credit bureaus could aid in collecting defaulted loans by providing an

incentive for repayment. However, this practice was impeded by the Family Rights and Privacy Act because, according to the Department, there were only limited situations in which a credit bureau would be authorized to disclose information about a defaulted loan to a third party. The Department had taken the position that the act would need to be amended before defaulted loan information could become a practical debt collection tool for schools. (See pp. 12 and 19.)

COLLECTION OF DEFAULTED NATIONAL DIRECT STUDENT LOANS HAMPERED

Schools have been permitted by law to submit defaulted loans to the Department of Education since 1972. However, it took almost 6 years to develop procedures to enable schools to forward National Direct Student Loans to the Department for collection.

Schools were advised that any defaulted loan forwarded to the Department before September 15, 1979, would not be included in the computation of the schools' default rate, which was a consideration in awarding Federal funds to schools for academic year 1980-81. This allowed schools with high default rates to continue receiving Federal funding under the loan program. (See p. 13.)

As of September 15, 1979, the Department had received from schools about 240,000 defaulted National Direct Student Loans with outstanding loan balances of nearly $215 million. Through March 1981, the Department had collected $5.8 million, most of which had been collected since December 1980. The Department's efforts to collect National Direct Student Loans had been hampered because

--schools failed to provide complete information--such as loan amounts, loan dates, and social security numbers--on defaulted loans;

--collecting these loans was not the highest priority of the Department's collectors--they were also responsible for collecting defaulted Guaranteed Student Loans, of which they have recovered nearly $110 million over the past 4 years; and

--a computer system to aid the Department in tracking, billing, and reporting on defaulted loans is not expected to be completed until the latter half of 1981. (See p. 20.)

Many of the loans turned over to the Department by schools GAO visited were in default for a number of years, which could make collection difficult. By law, loans must be in default for at least 2 years before they can be turned over to the Department. School officials and Department regional office collection officials believed that forwarding defaulted loans to the Department sooner could help to increase collections. (See p. 23.)

REDUCTION PLANNED IN THE NUMBER OF FEDERAL COLLECTORS

The Department plans to reduce the number of its collectors from 955 to 250 by January 1, 1982, and to contract out collections of defaulted loans. The Federal Claims Collection Standards (see p. 27) allow agencies to use private collectors, subject to certain limitations and guidelines. GAO believes that agencies are ultimately responsible for determining the extent to which contracting out is appropriate. The standards provide for the use of private collection agencies when it is cost effective and otherwise practical.

A Department task force study and a contracted study concluded that the use of private collection agencies would be at least as cost effective as the use of Department collectors. However, the statistics contained in these studies do not conclusively support that contention. The contracted study's cost data indicated that the collection efforts in one of the Department's regions were clearly outstanding and could not be duplicated by a private contractor. (See p. 25.)

Some Department regional officials raised several concerns regarding the use of private collection agencies and believed that these agencies would not be able to match the performance record of Federal collectors. (See p. 26.)

RECOMMENDATIONS TO THE SECRETARY OF EDUCATION

The Secretary should:

--Require schools to comply with the Department's loan collection procedures, particularly with respect to bringing suit against defaulted borrowers and submitting defaulted loans more quickly to collection agencies. (See p. 17.)

--Require schools to monitor results of collection agencies' actions. (See p. 17.)

--Establish limits for the time a loan remains with an agency for collection. (See p. 17.)

--Establish an acceptable default rate and suspend from the program or withhold Federal funds from schools that exceed the established default rate. (See p. 17.)

--Determine whether submissions of National Direct Student Loans to the Department for collection earlier than the statutory 2-year time limit would be beneficial to collection efforts and, if so, consider proposing legislation to allow schools to submit defaulted loans as soon as possible after completion of required collection activities. (See p. 28.)

--Propose legislation to allow credit bureaus to redisclose student loan data referred to them if the Department's review shows that such redisclosure is presently restricted by law. Should the Department find that present law does not restrict credit bureaus from redisclosing student default data, the Secretary should advise schools and credit bureaus of this matter. (See p. 17.)

--Monitor the Department's use of private collection agencies to insure that their use is the most cost-effective means of collecting defaulted student loans; any reassessment should consider the collection program that was in place in one of the Department's regions that was returning approximately $6 for every $1 spent. (See p. 28.)

DEPARTMENT OF EDUCATION COMMENTS AND GAO'S EVALUATION

In a draft of this report, GAO had proposed that the Department assess the economic feasibility of its plan to use private collection agencies to make sure that their use is the most cost-effective means of collecting defaulted student loans. GAO pointed out that any reassessment should consider the potential of agencywide application of the collection program presently in place in one region (San Francisco) that is returning $6 for every $1 spent. In its response to GAO's draft report (see app. I), the Department stated that it contacted the Office of Management and Budget (OMB) about the necessity for conducting a formal cost analysis as required by OMB Circular A-76 and was informed by OMB that such an analysis was not required.

The Department stated that it reviewed the best available evidence related to the use of private collection agencies (i.e., the contracted study discussed on p. 24) which showed that private sector pilot projects were performing efficiently and effectively. The Department further stated that there were a number of factors which could not be quantified in the analyses but which it believed strongly favored the private sector option and would swing the cost comparison in the private sector's favor.

The Department said, however, that it plans to examine the performance of the San Francisco regional office staff in an attempt to determine whether there really is a significant cost difference.

GAO believes that Federal agencies have the ultimate responsibility for determining the extent to which contracting with private collection agencies is appropriate. As noted on page 27 of this report, an April 17, 1981, amendment to the Federal Claims Collection Standards allows agencies to use private collection agencies when "it is cost effective and otherwise practical." While the Department's decision to use private collection agencies was based on the "best available evidence" as the Department pointed out, that evidence did not conclusively show that private collection agencies are more efficient or effective than Federal collectors.

Because the Department intends to award a collection contract soon, it may not be practicable to perform a detailed cost assessment before the contract is awarded. The Department, however, should monitor the performance of its collection contractors to insure that the collection of defaulted loans is being carried out in a manner that will return the most Federal dollars at the least cost to the Government.

The Department agreed to initiate action to allow commercial credit bureaus to redisclose student loan default data to the general credit industry. Thus, credit bureaus can now enter student loan default information into the credit information mainstream as they would any other credit information. (See p. 19.)

The Department agreed with GAO's other recommendations. Its comments are discussed on pages 17 and 29.

Contents

ABBREVIATIONS

ED	Department of Education
GAO	General Accounting Office
GSL	Guaranteed Student Loan
NDSL	National Direct Student Loan

CHAPTER 1

INTRODUCTION

The National Direct Student Loan (NDSL) program authorized by part D, title IV of the Higher Education Act of 1965, as amended (20 U.S.C. 1087 aa-ii), is a continuation of the National Defense Student Loan program authorized by title II of the National Defense Education Act of 1958 (Public Law 85-864). The program provides Federal funds to institutions of higher education to make long-term, low-interest loans to qualified students who need assistance in financing their education.

Generally, to be eligible for a loan a student must be a U.S. citizen, be enrolled at least half time at a participating higher education institution, and demonstrate financial need. Loans are made from revolving loan funds maintained by participating schools. The Federal Government provides 90 percent of the moneys for the revolving funds; the schools' share represents at least one-ninth of the Federal funds. Collections of principal and interest from prior loans are also deposited in the schools' revolving fund. The schools are responsible for making loans and collecting repayments either themselves or through an agent.

The Department of Education (ED) 1/ estimates that, for the 1980-81 school year, about 870,000 students received loans at about 3,100 participating schools. Since the program's inception, nearly $5 billion in Federal funds have supported loans to about 11 million students. As of June 30, 1979 (the most current date for which the data were available), about 875,000 students had defaulted loans with outstanding balances exceeding $730 million. The actual default rate 2/ for the program was 16.04 percent.

1/On October 17, 1979, the President signed the Department of Education Organization Act (Public Law 96-88) creating a Department of Education to administer all education programs that had been administered by the Department of Health, Education, and Welfare (HEW). The act also changed HEW's name to the Department of Health and Human Services. On May 4, 1980, responsibility for the activities discussed in this report was given to the new Department of Education.

2/The Department of Education determines "default rates" by dividing the principal amount outstanding on Defense and Direct Loans in default for 120 days if repayable in monthly installments, or 180 days if repayable in less frequent installments, by the matured loans (principal amount of all loans made minus the principal amount of loans that have not reached the repayment period).

As of June 30, 1979, 1,160 schools had default rates of 20 percent or higher. Of these, 315 had default rates of 41 percent or more. The following table shows the range of default rates for 3,153 schools participating in the NDSL program as of June 30, 1979.

Default rate range	Number of institutions	Percent of institutions
(Percent)		
0 - 9	1,291	40.95
10 - 19	702	22.26
20 - 30	559	17.73
31 - 40	286	9.07
41 - 50	139	4.41
51 - 60	101	3.20
61 - 70	46	1.46
71 - 80	17	0.54
81 - 90	9	0.29
91 - 100	3	0.09

STUDENT BORROWING

Before enactment of Public Law 96-374, the Education Amendments of 1980, dated October 3, 1980 (20 U.S.C. 1001), students could borrow: (a) $2,500 if they were enrolled in a vocational program or if they had completed less than 2 years of a program leading to a bachelor's degree, (b) $5,000 if they were undergraduate students and completed 2 years of study toward a bachelor's degree (this includes any amount borrowed under the NDSL program for the first 2 years of study), and (c) $10,000 for graduate or professional study (this includes any amount borrowed under the NDSL program for undergraduate study). Loans were made at a 3-percent interest rate. Public Law 96-374 increased the maximum amount that may be borrowed by the above three categories of students to $3,000, $6,000, and $12,000, respectively, and raised the interest rate to 4 percent.

Students are allowed a grace period before their initial loan payment is due. Before Public Law 96-374, loan repayments began 9 months after the student ceased to be enrolled on at least a half-time basis. Public Law 96-374 reduced the grace period to 6 months. Repayments, which may be spread over a 10-year period, may be deferred up to 3 years for service with VISTA, the Peace Corps, or military service.

PROGRAM REGULATIONS

In 1976, about 19 years after the original program was established, ED issued interim program regulations which required schools to be diligent and forceful in collecting student loans.

The regulations required schools to provide students with (1) information on their rights and obligations before making the loan, (2) exit interviews before they left school, (3) advance notices during the grace period of the due date for initial loan payment, (4) bills as payments became due, and (5) three past due notices and a final demand letter 75 days after a payment is missed. The regulations also required schools to search for borrowers with whom they had lost contact and attempt to collect from borrowers by using their own personnel or commercial collection agencies. Final regulations, which were subsequently issued, adopted the provisions of the interim regulations and added more specific requirements concerning past due notices. The final regulations also require schools to sue defaulted borrowers under certain conditions.

Before the interim regulations were issued, program manuals and other guidance provided to schools recommended the use of many procedures contained in the regulations.

In an effort to collect defaulted loans, in March 1978 ED established procedures to implement section 463(a)(4) of Public Law 92-318 (20 U.S.C. 1087(cc)) dated June 23, 1972, which permits schools to submit loans in default for 2 or more years to ED for collection. Schools must demonstrate that they have attempted to collect the defaulted loans before submitting them to ED.

OBJECTIVES, SCOPE, AND METHODOLOGY

Because of the growing concern over student loan defaults, our work focused on determining how well schools were carrying out their responsibilities for administering and collecting student loans and identifying conditions that might affect collections and default rates. In addition, we wanted to determine ED's progress in collecting defaulted loans forwarded to it by participating schools and those factors that have hampered its collection efforts. Two of our previous reports discussed the status of the NDSL program at selected schools and the need to improve the administration of the program. 1/ This report examines the collection aspects of the program.

We visited seven schools in the Midwest that included public and private schools with large and small student populations in rural and urban areas. These schools were selected on the basis

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1/"Status of Office of Education's National Direct Student Loan Funds at Selected Postsecondary Education Institutions" (HRD-78-94, May 2, 1978).

"The National Direct Student Loan Program Requires More Attention by the Office of Education and Participating Institutions" (HRD-77-109, June 27, 1977).

of default rates published by ED as of June 30, 1978, which were the latest available when we began our work. We obtained from the schools' fiscal operations reports submitted to ED for the period ended June 30, 1979, information on the schools' collection activities, including the number of (1) loans in default, (2) borrowers with whom the school lost contact, and (3) borrowers that were sued for collection.

In addition to the seven schools visited, similar information was obtained from fiscal operations reports for 33 other schools in the same geographical area with default rates exceeding 20 percent. Overall, default rates for 15 of the 40 schools exceeded 40 percent; 1 school had a default rate of 82 percent.

The seven schools visited were judgmentally selected and included mostly schools with high default rates. Therefore, our observations are applicable only to these schools. Default rates at six schools exceeded 20 percent; the highest was 63 percent. The seventh school had a 5.9-percent default rate.

During our visits to the seven schools between January and August 1980, we interviewed school officials and reviewed files on 599 defaulted loans. At five schools where the default rates were over 25 percent, we reviewed files on about 9 percent (470) of all loans in default as of December 31, 1979. Of these, 231 loans went into default before ED's 1976 interim regulations on loan collection and the other 239 afterwards.

At the school with the 5.9-percent default rate, we reviewed files on all 63 loans in default at June 30, 1980, which were made after ED's 1976 interim loan regulations became effective. For the school with a 21-percent default rate, we selected 66 loans representing 33 percent of all loans in default at June 30, 1980, involving students who graduated or dropped out of school on or after August 1, 1977.

From an ED report we obtained default rates as of June 30, 1979, for all 40 schools and compared them to previous years' default rates to determine whether the rates had declined. We reviewed ED's report showing funding awards for the 1980-81 school year to determine whether schools with high default rates were awarded additional NDSL funds.

We interviewed ED officials responsible for administering the program, visited two ED regional offices to determine their efforts in collecting defaulted loans which had outstanding principal balances of about $49 million as of May 1980, and reviewed available Certified Public Accounting and ED reports relating to the schools' NDSL programs.

Since completion of our work, on March 18, 1981, ED announced its plans to reduce the number of Federal collectors and contract with private collection agencies for the recovery of defaulted student loans. ED's plan was based, in part, on its task force report and a private contractor study, both of which addressed the Federal versus commercial collection activities. We reviewed the studies.

CHAPTER 2

WEAKNESSES IN SCHOOL LOAN COLLECTION PROCEDURES

The seven schools we visited did not fully comply with all of ED's collection procedures. Though they generally did an adequate job sending bills and collection letters, improvements should be made in other areas. Some schools were remiss in counseling borrowers and maintaining contact with them both before they left school and during the grace period. Most schools could not locate borrowers with whom they had lost contact.

The schools often did not refer defaulted accounts promptly to collection agencies, monitor referred accounts, and determine the collection agencies' success. All seven schools had been reluctant to sue borrowers to collect defaulted loans which may have contributed to the high default rates.

None of the seven schools referred defaulted borrowers to credit bureaus. Schools are permitted to refer them to credit bureaus, but there are only limited situations in which a credit bureau would be authorized to disclose information about an NDSL defaulter to a third party. Such a restriction impedes the effectiveness of reporting to a credit bureau.

Recent audit reports issued by Certified Public Accounting firms concerning four of the five schools we visited recommended that they place greater emphasis on collections. Many of the defaulted loans have recently been turned over to ED for collection. (See ch. 3 for ED's collection efforts.)

BORROWERS NOT GENERALLY INFORMED OF RIGHTS AND OBLIGATIONS

ED regulations require schools to inform students of their rights and obligations before NDSL funds are given to them and again before they leave school. Although preloan counseling interviews are not required, ED strongly recommends that schools inform students of their rights and obligations through personal interviews. If an interview is not held, a statement of obligations must be given to the borrower, and the schools are urged to have borrowers sign or initial a statement indicating their rights and responsibilities have been explained to them. If a borrower leaves school without notice, the school must mail two copies of the information that is required to be covered in the exit counseling session and request the borrower to sign and return one copy. Counseling sessions give the borrower and the school an opportunity to review the terms of the note, explain rights and obligations, and resolve problems.

At the seven schools visited, officials told us they provided preloan and exit counseling to all borrowers. However, the records we reviewed at these schools did not contain evidence that all borrowers were provided such counseling.

Of the 599 loan files reviewed at the seven schools, 431 (72 percent) did not contain evidence that preloan counseling was provided to borrowers. We were told at one school that preloan counseling had been initiated only during the past 2 years; at another school it had been initiated in the spring of 1979, when it became mandatory for all students. Officials at four schools told us that some students do not realize they are receiving loans.

Regarding exit counseling, our review of defaulted loan files showed that 13 percent or 78 of the 599 students sampled were personally counseled before leaving school. Of the other 521 students, 38 percent or 198 students were mailed counseling information as required, but only about 19 percent or 38 students responded. According to officials at two schools, student response to mail counseling was generally poor.

The five schools with the highest default rates did a poor job of providing exit interviews. Documentation at these schools showed that only 152 of the 470 defaulted borrowers sampled were personally counseled or mailed counseling data. One of these schools had no documentation to show that any of the 88 borrowers in our sample received personal exit interviews. Documentation at the two schools with the lowest default rates showed that 124 of the 129 defaulted borrowers were personally counseled or mailed counseling data.

School officials gave various reasons why personal exit counseling was not always done. Some students dropped out of school without notifying the school. Locating these students and counseling them is extremely difficult. Sometimes the business office was not notified for several weeks of students who officially withdrew from school or who graduated, making personal counseling virtually impossible. Frequently, students did not show up for scheduled counseling appointments. At one school, until May 1980 exit counseling was done for spring graduates only, and many of them failed to appear for scheduled counseling. Since then, however, exit counseling is provided quarterly to students.

ADEQUATE GRACE-PERIOD NOTICES NOT PROVIDED TO BORROWERS

Once students cease to be enrolled on at least a halftime basis, a grace period is allowed before the initial payment on the loan is due. For those loans in our sample, the grace period was 9 months. ED regulations required schools during the 9-month

grace period to notify borrowers three times during the grace period--90, 180, and 240 days after they leave school--of pending payments due. The notices are intended to facilitate billing for loan payments. Schools, however, did not always send the required grace-period notices.

Our review of 46 defaulted loan files at one school showed that 36 borrowers were not provided grace-period notices. According to recent audits by Certified Public Accounting firms, three schools were not sending out grace-period notices at the prescribed times. The audit reports noted that, during the grace period, one school sent only one notice, the two other schools sent only two notices. A Certified Public Accounting firm's audit report for another school noted that it did not promptly notify its billing agency when borrowers entered the grace period to ensure notices are sent out on time. (Some schools used commercial billing agencies to send out grace-period notices.) The failure to send grace-period notices to borrowers may partially explain why 66 percent or 346 of the defaulted borrowers included in our sample at six of the schools we visited had not made any payment on their loans.

SCHOOL COLLECTION PRACTICES ARE WEAK

Schools must attempt to locate defaulted borrowers and, if successful, send them three past due notices and a demand letter 75 days after a payment is missed. The seven schools generally complied with the requirements concerning past due notices when the borrowers could be located; however, the schools frequently lost contact with them. Also, (1) demand letters sometimes were not strong enough to make them effective, (2) the seven schools generally did not promptly send defaulted accounts to collection agencies, and (3) the schools had been reluctant to sue borrowers.

Schools lose contact with defaulted borrowers

If the location of a borrower is not known, ED regulations require schools to conduct an address search, which is referred to as skip-tracing. A school may do its own skip-tracing using the Internal Revenue Service and other sources, such as school records, telephone directories, and motor vehicle registration and licensing records. It may also hire a skip-tracing agency to locate borrowers.

Fiscal operations reports at the seven schools visited showed that these schools did not know the location of about 1,900 borrowers who, as of June 30, 1979, had outstanding loans totaling nearly $1.6 million. The fiscal operations reports for 33 other schools showed that they did not know the location of more than 8,000 borrowers whose outstanding loan balance as of June 30, 1979, totaled $5.4 million.

Some schools we visited did little to locate borrowers. At one school no skip-tracing activity was done--all accounts 90 days old were sent to a collection agency. Two other schools did a limited amount of skip-tracing.

Stronger demand letters could be more effective

Regarding demand letters, officials at two schools said their schools' demand letters were weak and should contain more forceful language. The letters used by one school informed borrowers that their account was past due and simply encouraged the defaulter to make a payment or indicate why one could not be made. A school official said he desired stronger letters, but was advised by the school's legal counsel not to change these letters.

At the second school, until recently demand letters reminded students that a balance was due on their account and that a check would be appreciated. The school revised its collection letters, so that the letters now inform the defaulted borrower that if payments are not received the school will use the services of a collection agency or initiate litigation.

Schools need to make better use of collection agencies

The records at the seven schools showed that 245 (41 percent) of the 599 defaulted loans had been sent to collection agencies. Some defaulted loans were not referred to collection agencies because borrowers were granted deferments or made payments on their loans after receiving several demand letters. Many other loans not referred to collection agencies were in default for several years. Some schools were in the process of forwarding defaulted loans to collection agencies at the time of our visit.

Only two schools sent defaulted accounts to a collection agency on a regular basis. One of these used its own collection specialist first, but referred all uncollectible accounts to a collection agency after 6 months. The other referred all accounts that were 90 days past due to a collection agency.

At the other five schools, in many cases substantial time elapsed between the last contact with the borrower and referral to a collection agency. School officials provided varying explanations for the delays:

--One school had not referred any loans to a collection agency for over 2 years because it was in the process of selecting a new collection agency. The school left accounts with billing agencies for 2 and 3 years before referring them to a collection agency. During the period the accounts

were with the billing agency, the school attempted collection only when staff became available.

--A second school referred accounts to collection agencies only when the address of the borrower was known. However, the school was able to locate very few of its borrowers and thus made few referrals to collection agencies.

--A third school lacked staff to review loan accounts on a timely basis and refer them to collection agencies.

--A fourth school suspended the use of collection agencies for over a year. When use of collection agencies resumed, the school had insufficient staff to review and refer accounts, where appropriate, to collection agencies on a timely basis.

--The fifth school did not have a collection manager for about 4 months. Its former manager had been lax in handling collections. The newly hired manager told us he planned to begin referring accounts to collection agencies more quickly. He said that, in the past, billing stopped on an account when it was 120 days past due and presumed to be with a collection agency. He said in many cases the school was not referring the accounts to a collection agency or following up with the borrower.

A collection agency official told us that chances for collecting are best during the first 3 months after default if sufficient background information about the borrower is provided.

Once accounts were placed with collection agencies, the schools generally stopped monitoring the accounts. Only two of the seven schools gave collection agencies a time limit for collecting referred loans. After 6 months, these schools required the agencies to return all uncollected accounts. The other five schools left accounts with collection agencies until the agencies decided to return them to the schools. Loan accounts referred by one school remained with the collection agencies for up to 3 years, with the average being about 1 year. Records at another school indicated that, as of March 1980, 24 accounts had been with a collection agency for over 2 years; no payments were received on 8 of these accounts.

We asked three collection agency officials what percentage of NDSLs are collected. One said about 50 percent of the dollars referred are collected, another said 35 to 40 percent of the accounts were collected, and the third said that depending on the school, 10 to 90 percent of the accounts are collected. Statistical reports from another collection agency indicated that about 12 percent of the dollar amounts referred by one school has been collected.

The following table shows for the seven schools the dollar value of loans referred to collection agencies as of July 1, 1978, and the amounts collected during the year. This information was obtained from fiscal operations reports submitted to ED by the schools. It does not include amounts referred to or returned by collection agencies during the year.

School	Loan amounts referred as of 7/1/78	Loan amounts collected (note a) between 7/1/78 to 6/30/79
A	$272,257	$15,063
B	51,608	110
C	43,422	4,347
D	25,503	3,582
b/E	932,918	6,423
F	184,804	25,574
G	262,404	35,573

a/One-third of the amounts collected generally is paid to the collection agency as its fee.

b/Instructions for filling out fiscal operations reports advise schools to report the total principal amount outstanding if that amount has been declared due and if the school has turned the entire amount over to a collection agency. The amount School E reported represented the total principal amount outstanding on defaulted loans rather than only the past due amount referred to collection agencies.

Officials at three schools expressed concern about the small amounts being collected by the agencies. Two of the schools had recently changed collection agencies, while the other school was contemplating a change.

Schools have been reluctant to sue borrowers

After all collection efforts have failed, ED's loan collection regulations require that a school sue the borrower if (1) the borrower can be located, (2) the borrower owes over $500, (3) the borrower has assets that will cover the outstanding debts, and (4) the borrower has no known legal defense (e.g., statute of limitations). However, schools are not prohibited by the regulations from seeking litigation if the four conditions are not met.

Only three of the seven schools visited had brought suits against defaulters. According to fiscal operations reports, as of June 30, 1979, the three schools were in the process of suing

33 borrowers. A fourth school had recently begun litigation on a few cases. The seven schools had about 7,100 defaulted loans with outstanding loan balances of $7.2 million as of June 30, 1979.

Officials at three schools told us that the schools have been reluctant to litigate in the past, not wanting to tarnish their image. An official at one of these schools said that the school was reluctant to sue graduates because school officials did not want to jeopardize potential contributions to their alumni funds. However, officials at six of the seven schools said they are now ready to sue borrowers when warranted. Officials at the seventh school still are reluctant to sue borrowers and, in fact, have refused to authorize suits against four defaulters who had been recommended for litigation by a collection agency.

The fiscal operations reports for 33 other schools showed that 9 schools as of June 30, 1979, were in the process of suing 149 borrowers. A regional manager of a national collection agency told us he believes that most schools are not as interested in collecting loans as they are in maintaining their image and, therefore, prefer not to sue defaulted borrowers even when a suit is warranted. He said that one school still refuses to bring suit against any defaulted borrower.

USE OF DEFAULT DATA BY CREDIT BUREAUS HAS BEEN LIMITED

In reviewing collection procedures, we asked school officials if they referred defaulted borrowers to credit bureaus. None of the seven schools visited had made referrals even though several school officials believed referrals could help in collecting defaulted loans. One school official added that borrowers often do not repay their NDSLs because they know that their credit will not be affected.

An ED official stated that schools are encouraged to use credit bureaus in an effort to collect defaulted loans. Reporting NDSL defaulters to commercial credit bureaus could provide an incentive for repayment. A defaulter's failure to pay could prevent the individual from obtaining future credit since other lending institutions are warned that the person may be unable or unwilling to pay outstanding debts.

However, the effectiveness of reporting defaulted loans to credit bureaus is impeded by the Family Educational Rights and Privacy Act (commonly referred to as the Buckley Amendment). This Amendment regulates the disclosure of information from the educational records of schools in order to protect the privacy of parents and students. The Amendment allows schools to disclose personal information without the prior written consent of the

student in connection with financial aid received. However, the party to whom the information is disclosed may, according to ED, be restricted from disclosing it to others.

ED addressed the effect of this Amendment on reporting NDSL default information in a February 1980 letter to a Member of Congress. In that letter, ED concluded that the Amendment would allow a school to disclose defaulted loan information to a credit bureau as part of the school's collection effort. ED pointed out, however, that this disclosure would be subject to a condition--that the party to whom the information is disclosed would not redisclose it without the student's prior written consent or unless otherwise authorized to do so. ED recognized that there are only limited situations in which a credit bureau would be authorized to redisclose information about an NDSL default, such as where another school makes a credit inquiry to the credit bureau because the student had applied for additional assistance. ED recognized that the restriction on redisclosure imposed by the Amendment impedes the effectiveness of reporting as a debt collection tool. It concluded that the Buckley Amendment would need to be amended if the reporting of NDSL default information to a credit bureau was to become a practical debt collection device for schools to use.

During an earlier review of public and private sector debt collection practices, 1/ private-sector credit industry officials told us that the single most powerful motivation for individuals to pay their debt was the stigma of having their credit ratings reflect that they have not paid debts on time. The vast majority of Americans rely on credit to buy the things they need. Industry and credit bureau people we questioned said that, when faced with the loss of credit, the majority agree to pay their bills.

An ED official advised us that credit bureaus are unwilling to accept information on defaulted NDSL borrowers if such information cannot be used to respond to all inquiries about a person's credit worthiness. Since its February 1980 letter, questions concerning disclosure authority of credit bureaus under the Buckley Amendment have been raised. According to ED, it recently obtained a legal reinterpretation of the act. Credit bureaus can now enter student loan default information into the credit information mainstream as they would any other credit information. (See p. 19.)

SCHOOLS WITH HIGH DEFAULT RATES CONTINUE TO RECEIVE FEDERAL FUNDS

ED continues to make additional NDSL funds available to schools that have high default rates. Many schools were able to assign or refer a significant number of defaulted loans to ED for

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1/"The Government Can Be More Productive in Collecting Its Debts by Following Commercial Practices" (FGMSD-78-59, Feb. 23, 1979).

collection, thereby reducing their default rates and qualifying them for additional NDSL funds. (See p. 21 for details on assigning and referring loans to ED.)

For the school year 1980-81, schools were eligible to receive additional NDSL funds if they had a default rate that

(a) was 10 percent or less;

(b) was more than 10 percent but declined by at least 25 percent from the previous year; or

(c) was more than 10 percent, but the school demonstrated it was following sound loan servicing and collection practices.

For the award year 1979-80, NDSL funds to schools were reduced if they did not meet similar criteria. According to an ED official, Federal NDSL funds to 1,260 schools for the 1979-80 award year were reduced by about $90 million. However, he said that few schools were declared ineligible for funds for the 1980-81 award year because they were able to assign or refer enough defaulted loans to reduce their default rate by 25 percent or certify that they were following sound loan collection procedures. The ED official said the certification was accomplished by schools indicating on an ED form whether or not loan collection procedures were being followed and having the schools' chief financial aid officer indicate that the form had been correctly filled out.

Although school default rates for some schools have been reduced, the NDSL program overall continues to have a high default rate--16.04 percent as of June 30, 1979, (latest date for which ED has calculated the default rate). Fiscal operations reports we reviewed for the 40 schools showed that about 16,000 borrowers had loans in default for 2 or more years and that as of September 15, 1979, 11,400 loans with outstanding balances totaling $8.5 million had been assigned or referred to ED.

At the seven schools, loans to about 4,240 borrowers had been in default for 2 or more years, and the schools had referred or assigned to ED 2,151 loans with outstanding balances totaling $1.9 million. Officials at two schools holding most of the other 2,089 old loans told us that the lack of staff prevented them from sending defaulted loans to ED. Officials at two other schools stated that they were unable to document collection attempts as required by ED regulations before such loans could be forwarded to ED.

The loans assigned or referred to ED by the seven schools before September 15, 1979, were not included as part of the schools' default rate in determining whether they were to

receive 1980-81 Federal funds. The following table shows default rates for 1978 and 1979 at the seven schools and the effect of not including assigned or referred loans in the default rates. The default rates for 1979 in column A were calculated by deleting assigned or referred loans to ED; the rates in column B include such loans and represent the schools' actual default rates.

School	Default rates		
	June 30, 1978	June 30, 1979	
		A	B
	(Percent)		
A	45.7	29.2	40.6
B	60.4	58.0	72.2
C	63.1	23.4	58.3
D	45.9	46.4	48.7
E	32.6	21.6	39.5
F	5.9	4.9	7.0
G	21.1	13.5	15.9

Three of the five schools with the highest default rates were funded for the 1980-81 school year. Two of these schools, whose default rates during June 1978 to June 1979 increased from 60.4 and 32.6 percent to 72.2 and 39.5 percent, respectively, received Federal funds of $90,000 and $496,000 for the 1980-81 award year. Both schools were also funded during the 1979-80 award year. The third school whose default rate dropped from 45.7 to 40.6 percent received additional NDSL funds of $240,000 for the 1980-81 year. This school was not funded the previous year.

Of the other two schools, one discontinued its participation in the NDSL program while the other school was authorized to continue making loans from balances in its revolving fund. An ED official stated that ED conducted only one NDSL program review over the past 3 years at the six schools visited with the highest default rates. The report on this review recommended that the school strengthen its collection efforts and develop a long-term plan to reduce its default rate.

In addition to the seven schools visited, similar reductions in default rates were noted for 32 of 33 other schools. For example, by assigning or referring defaulted loans to ED, default rates for three schools were reduced from 55.0, 36.5, and 56.2 percent to 23.1, 2.5, and 24.8 percent, respectively. Default rates at 20 of the 33 schools were below 20 percent when loans assigned or referred to ED were not included in their default rate computation. However, when assigned or referred loans were considered, only 6 of the 20 schools had default rates below 20 percent.

An analysis of ED funding awards for 33 schools based on default rates that included assigned or referred loans showed:

--Twenty-six of the 33 schools received NDSL funding awards for 1980-81 even though 22 of these schools continued to have default rates exceeding 20 percent.

--Nine schools whose 1979 default rates exceeded their previous year's default rates received NDSL funds for 1980-81, with six of the awards exceeding the previous year's funding; one school's default rate increased from 69.8 to 71.0 percent while another's rate increased from 28.9 to 33.1 percent. Neither school was funded during the 1979-80 year, but they received awards of $303,813 and $176,241, respectively, for the 1980-81 period.

CONCLUSIONS

Tougher collection practices are needed if schools are to reduce their default rates and recover past due amounts on NDSLs. Schools we visited generally were lax in following ED collection procedures, which has contributed to the program's high default rate. At several of the schools visited, many borrowers were not making any payments on their loans.

Schools should do several things to improve their debt collection process. Schools that have referred loans to collection agencies should closely monitor the collection status of such loans to help them consider other options for collection when these agencies are not successful in recovering defaulted loans. Litigation, which was seldom used, could be an effective step in recovering defaulted loans, and schools should make greater use of it when warranted.

Reporting defaulters to commercial credit bureaus could provide an incentive for payment. However, according to ED, use of this information by credit bureaus may be restricted. Unrestricted disclosure of NDSL defaulters by credit bureaus to third parties would seem necessary to make such reporting an effective collection tool. ED is presently reviewing this matter. Should ED confirm its initial finding that credit bureaus are restricted in disclosing student default data to other parties, it should propose legislation to allow such disclosure.

Although, by excluding from a school's default rate loans assigned or referred to it, ED has encouraged the submission of loans for collection, it has done little to require schools to improve their loan collection efforts. ED seems to reward schools with chronic high default rates by allowing them to receive additional funds under the NDSL program.

The initial responsibility for loan collection rests with the schools and when they fail to perform effectively, sanctions should be considered, including withholding of Federal funds or suspension from the NDSL program. It is important that schools adequately demonstrate sound loan collection practices or the program will continue to be plagued with a high default rate.

RECOMMENDATIONS TO THE SECRETARY OF EDUCATION

We recommend that the Secretary:

--Require schools to comply with ED's loan collection procedures, particularly with respect to bringing suit against defaulted borrowers and submitting defaulted loans more quickly to collection agencies.

--Require schools to monitor results of collection agencies' actions.

--Establish limits for the time a loan remains with an agency for collection.

--Establish an acceptable default rate and suspend from the program or withhold Federal funds from schools that exceed the established default rate.

--Propose legislation to allow credit bureaus to redisclose student default data referred to them if ED's review shows that such redisclosure is presently restricted by law. Should ED find that the present law does not restrict credit bureaus from redisclosing student default data, the Secretary should advise schools and credit bureaus of this matter.

AGENCY COMMENTS

ED, in commenting on our draft report (see app. I), said that it agreed with our recommendations. ED's specific comments on each recommendation is presented below.

Compliance with loan collection procedures

ED said it is tightening its program review effort in the area of NDSL billing, collection, and litigation to more specifically pinpoint the areas of noncompliance and require corrective action. Where such action is not forthcoming, steps may be taken to require the institution to buy the loan, to reduce or withhold Federal funds, or to take limitation, suspension, fine, or termination action against the institution.

Schools monitor collection agency actions

ED said that a notice will be sent to each participating institution to emphasize the fact that, as stated in the regulations, institutions are responsible for all decisions in administering the NDSL program, including decisions concerning collecting, cancelling, or deferring loans, and that an institution cannot absolve itself of responsibility by hiring a collection agency. Where it is discovered, through program reviews, audits, etc., that a collection agency is not adequately performing in an acceptable fashion, appropriate action will be taken against the institution.

ED added that it was proposing for the next award year that, in order to appeal its denial of NDSL Federal funds, an institution will have to show, using actual data, that its default rate has decreased over the past two years.

Establish time limits on loans with collection agencies

ED said it is revising its NDSL regulations and as a part of the revision it is proposing a limit on the amount of time a collection agency may work on an account. In addition, ED is considering establishing time frames in which institutions must litigate the loan, pursue further collection activities, or assign it to the U.S. Government.

Establish an acceptable default rate and enforce compliance with it

ED said that the funding procedures for the NDSL program have always applied a penalty against an institution's NDSL award if its default rate was excessive. In processing requests for NDSL funds for the 1981-82 award year, approximately 385 institutions were denied Federal funds due to their default rate.

ED explained that a Notice of Proposed Rulemaking on the funding procedures used to distribute NDSL funds is in the clearance process. The Notice contains a default penalty which has a direct impact on an institution's receipt of Federal funds. The proposed rule requires that an institution's default rate will have to be 25 percent or less in order for the institution to receive any NDSL Federal funds. Those institutions with a default rate between 10 and 25 percent will have a penalty applied to the amount of NDSL Federal funds they are to receive. The penalty will be determined by calculating the amount of funds an institution would have collected if its default rate were 10 percent and subtracting that amount from the amount of NDSL Federal funds the institution is scheduled to receive.

Allow credit bureaus to redisclose student default data

ED explained that its Office of Student Financial Assistance has actively sought to overcome the restrictions which prevented the practical exchange of student default information between school lenders, credit bureaus, and the general credit industry. Recently, that Office was successful in obtaining a legal reinterpretation of the Family Educational Rights and Privacy Act which would authorize school lenders to make disclosures of student loan default information to credit bureaus without the previous restrictions on redisclosures of the default information by the credit bureaus. Thus, credit bureaus can now enter this student loan default information into the credit information mainstream as they would any other credit information. ED stated that it is in the process of informing the schools of this development and of the availability of this important new collection tool.

CHAPTER 3

PROBLEMS WITH COLLECTING DEFAULTED NATIONAL DIRECT STUDENT LOANS

The NDSL program continues to be plagued by high default rates. ED's most current information shows that outstanding defaulted loans as of June 30, 1979, exceeded $730 million, an increase over the previous year of about $29.2 million. During the past 1-1/2 year, schools participating in the NDSL program have submitted to ED about 240,000 defaulted loans with outstanding balances of $215 million. Although most of these loans were received over a year ago, ED's efforts to collect loans have been slow. Through March 1981 ED had collected $5.8 million. However, more recently ED's collection activities have improved. In March 1981 ED's collections of defaulted NDSLs were $818,000, almost double the amount collected during December 1980.

FACTORS HAMPERING ED'S COLLECTION EFFORTS

ED's collection efforts have been hampered by several factors. One is ED's delay in establishing procedures for submission of defaulted loans to it. Other factors include (1) the failure of schools to provide accurate or complete information on defaulted loans submitted to ED, (2) the limited number of ED staff assigned to the collection of defaulted NDSLs, and (3) the lack of a computer system to aid ED in tracking, billing, and reporting on defaulted loans. Many loans submitted to ED for collection had been in default for years, which may also hinder ED's collection efforts.

ED has now obtained the needed information on many loans, and according to an ED official, the computer system for defaulted NDSLs is expected to be operational during the latter half of 1981. Recently, however, ED decided to reduce its loan collection staff and to contract with private concerns for the collection of defaulted loans. A recent amendment to the Federal Claims Collection Standards 1/ (4 CFR 101-105) encourages the use of private collection agencies, subject to certain limitations and guidelines. We noted, however, that the cost effectiveness of using private collection agencies in lieu of ED staff for loan collections has not been clearly established. Some ED regional office collection staff disagree with ED's position that private collection agencies will be as effective as ED's collection staff.

1/The Standards are issued jointly by the Comptroller General and the Attorney General of the United States as required by the Federal Claims Collection Act of 1966 (31 U.S.C. 951).

ED slow in establishing procedures for submission of defaulted NDSLs

Since 1972 schools have been permitted by law to submit defaulted loans to ED for collection. Section 463 (a)(4) of Public Law 92-318 (20 U.S.C. 1087(cc)) dated June 23, 1972, permits schools to assign loans that have been in default for 2 or more years to ED for collection if they can demonstrate that they have attempted to collect the defaulted loans. However, ED did not establish procedures for schools to submit defaulted loans to it until March 1978. As of January 1979, schools had assigned fewer than 500 loans to ED.

A December 1978 internal report to the Secretary of Health, Education, and Welfare stated that few loans had been assigned because schools were apparently concerned about losing their 10 percent share of the amount collected. Assigned loans become the property of the Government, and all collections are deposited with the Department of the Treasury. To provide an incentive for schools to assign more loans, ED informed schools in May 1979 that loans assigned by June 30, 1979, would be excluded from the computation of the schools' June 30, 1979, default rates. Default rates can adversely affect the additional Federal contributions a school receives.

Subsequently, the Higher Education Technical Amendments of 1979 (20 U.S.C. 1001 et seq.) permitted schools to refer rather than assign defaulted loans to ED. Unlike assigned loans, title to referred loans remains with the schools, and ED charges a fee of 20 percent of the amount collected, returning the remainder of the collection to the school. In implementing the amendments ED advised schools that any loan referred before September 15, 1979, would not be considered part of their default rate in determining whether they would receive a 1980-81 Federal contribution. Loans referred after September 15 would not reduce the schools' default rate. About 240,000 loans valued at $215 million had been turned over to ED for collection as of September 15, 1979. An ED official stated that nearly all of these loans were referred rather than assigned to ED.

Adequate data on defaulted loans not always submitted to ED

ED's collections on NDSLs were delayed because schools did not provide accurate or complete information on defaulted loans submitted to ED or loans that should not have been submitted. For example:

--According to ED, at least 55,000 of 238,000 loans submitted before September 15, 1979, lacked data on original loan amounts and loan date, amount repaid, and social security number of borrowers.

--Schools submitted defaulted loans under erroneous school identification numbers, which resulted in an inaccurate defaulted loan inventory for individual schools.

--Schools submitted defaulted loans that lacked promissory notes and documentation of collection actions.

--Some loans had not been in default for at least 2 years and, therefore, were ineligible for submission to ED.

--Schools submitted loans without notifying collection agencies to cease collection actions on them. Some collection agencies received payments from borrowers after loans were sent to ED.

One ED regional collection official said that it took over a year to reconstruct student loan records turned over by the schools before any collection action could be taken on the loans. ED collection officials told us many of the defaulted NDSLs are now ready for collection.

Limited staff assigned to collect NDSLs

ED distributed the 240,000 defaulted NDSLs submitted by schools to its 10 regional offices for collection. The regional offices' NDSL defaulted loan portfolios ranged from about $4 million to $39 million, with some regions responsible for collecting as many as 43,000 defaulted loans. In addition to collecting defaulted NDSLs, regional offices were also responsible for collecting defaulted federally insured Guaranteed Student Loans (GSLs). 1/ According to an October 1980 ED task force estimate, there were 325,000 federally insured GSLs in ED's inventory. ED had assigned about 85 percent of its approximately 1,000 collection staff to defaulted GSLs which were viewed as the major priority. The other 15 percent were assigned to defaulted NDSLs.

During March and May of 1980, we visited two ED regional offices that were respectively assigned about 11,000 and 43,000 defaulted NDSLs with outstanding balances of $10 million and $39 million. One region had three staff members assigned to work on the 11,000 defaulted NDSLs. The other region had a staff of nine to work its 43,000 defaulted NDSLs.

1/The Guaranteed Student Loan program provides financial assistance to students through lending institutions. The loans are insured by the Federal Government or State agencies.

NDSL computer system not fully operational

ED is developing an interim computer system to aid in the tracking, billing, and financial reporting of defaulted NDSLs. The system is not yet fully operational. Presently, the system is used to record amounts owed and payments on defaulted loans. The other collection activities of tracking and billing borrowers continue to be handled manually. An ED collection official said that the NDSL computer system is expected to be completed during the latter half of 1981.

NDSLs submitted to ED for collection are old

NDSLs submitted to ED for collection are at least 33 months old, which could make collection difficult. Legislative requirements account for part of the age of defaulted NDSLs turned over to ED. The statutory prohibition against assigning loans to ED that are less than 2 years old and the 9-month grace period on repayments account for 33 months of the age of loans submitted to ED. However, many loans submitted to ED were much older.

An official at a school that forwarded 893 loans to ED stated that all of the loans had gone into default before November 1976. All 85 loans forwarded to ED by another school had gone into default before August 1977. Our analysis of 388 loans at a third school showed that 147 had been in default for over 4 years. Many school officials and ED collection officials in two regional offices we talked to believed that sending loans to ED sooner could increase the probability of collection.

ED PLANS TO REDUCE THE NUMBER OF FEDERAL COLLECTORS AND USE PRIVATE COLLECTION AGENCIES

Recently ED announced its plan to reduce the number of ED collectors and contract with private collection agencies to collect defaulted student loans.

In a March 18, 1981, memorandum, the Secretary of ED noted that the collection of loans was not integral to ED's mission and that the private sector has demonstrated that it can be at least as effective as ED in collecting loans. According to the memorandum, ED collection operations in 10 regions will be consolidated into 3 regions with the number of ED collectors reduced from 955 to 390 by September 30, 1981, and further reduced to 250 by January 1, 1982. ED regional offices are expected to transfer collection accounts to a contractor as soon as one is selected. An ED official stated that the selection is to be completed by the fall of 1981.

In an April 28, 1981, letter to the Chairman, House Subcommittee on Postsecondary Education, the Secretary of ED stated that the decision to contract out most of the loan collection function was based on various factors. These include an internal ED task force analysis and an ED contracted study report.

The ED task force concluded that collection agency efforts would be at least as cost effective as ED's efforts, if not more so. The task force noted, however, that it had a relatively short time (from Sept. 2, 1980, to Oct. 6, 1980) to prepare the report and encountered problems in determining ED's internal costs associated with collecting defaulted loans and private agency commissions. The task force added that

> "* * * given the paucity of reliable information available to the task force, the calculations represent the best estimate we could make in determining costs. Using this as a basis, it would appear that the private collection agencies are at least as efficient as ED's regional offices."

A major part of the ED contracted study was to determine the impact of staffing reductions on the collection program as well as to suggest alternative operating methods. The study also analyzed collection activities of student aid programs. The study was concerned primarily with collections of defaulted GSLs.

The report noted that before 1977 few ED resources were applied to collection and this lack of emphasis resulted in less than $30 million in collections from 1967 through 1976. Beginning in 1977 collections were made a major priority with efforts targeted at federally insured GSLs. Hiring 1,000 temporary employees, retaining two private collection agencies, and developing computerized capability resulted in $110 million collected from 1977 through September 1980. Collections by private agencies were estimated to be $5.5 million (3.4 percent) of the total collections.

According to the report, ED's costs to collect these loans totaled about $49 million which included about $2.6 million for the support of two private contractors.

The executive summary to the report concluded that:

> "No significant difference exists in the cost-effectiveness of Federal and contractor collection efforts. The calculated cost-effectiveness ratio for Federal staff <u>appears</u> to be significantly better than for contract agency collections. The basic numbers suggest that Federal staff collect $3.50 of debt for each dollar of cost incurred whereas the contractor yield is about $2.20 for each dollar of their cost

paid by the Federal government. However, because contractors have received collection accounts already 'worked' by Federal staff, these ratios are not meaningful. We believe that fully comparable cases would show little difference in cost-effectiveness. Regardless of the functions conducted by private collection agencies, the Department is ultimately responsible for final resolution of accounts, and needs to perform several collection activities with its own staff."

ED's San Francisco region was recovering $5.90 for each dollar of cost. The report noted that this region's performance was clearly outstanding and not achievable by a contractor.

The report made several recommendations dealing with organizational, operational, and procedural improvements needed in the loan collection process and offered three options aimed at resolving the backlog of accounts and the expeditious handling of new accounts.

One option suggested continuation of a fully staffed 10-regional-office structure with its full staffing complement through fiscal year 1982 and contractor support to assist with collections. This option presumes a likely reduction in staff to only those needed for ongoing collection (estimated to be 600) at the end of fiscal year 1982. The contractor stated that in its judgment this option would not fully meet the objective of developing and implementing an organization, procedures, and systems which would provide a sound basis for handling future workload. The regional collection operations would still be spread out in 10 regions, making it difficult to control. However, this option was expected to allow ED time to develop plans for future staff reductions and regional consolidation.

A second option was to reduce the number of ED collectors to 530 and consolidate into three ED regions by the end of fiscal year 1981 with extensive collection agency support to handle most of the 800,000 unresolved accounts, including NDSLs, GSLs, and loans to students under other Federal student aid programs. The report noted that there is some risk that ED will not be able to effectively plan and implement this option within the short period remaining before the end of fiscal year 1981.

The third option would further reduce the Federal collectors to 230 by the end of fiscal year 1982 with all collections being made by private agencies. Federal staff would not perform any collection activities under this option. Regarding this option, the report added that there are inherent risks in the planning and implementation of a major shift in program size and characteristics. The report stated that a significant Federal effort

is required under any contractor option and, regardless of the option, estimated that about $2 would be recovered for every dollar of cost.

Concerns have been raised over the decision to replace Federal collectors with private collection agencies. An ED regional official responsible for claims and collections in commenting on the task force report stated that private collection agencies are not capable of matching ED's performance record. He said that collection agencies can be of service as a supplement to the ED collection efforts. He stated that:

--Collection agencies are only concerned with debtors who show an immediate willingness to pay. All other accounts are set aside for return to the client. By "creaming" up to 10 percent of a client's accounts, an agency can move on to the next client or next batch of accounts, instead of attempting to work the more difficult accounts from the previous batch. This system proves to be very successful for the collection agency but not for the client.

--In his region 90 percent of the defaulted NDSL accounts being worked had been through at least one collection agency and sometimes two or three. The region succeeded in putting accounts into repayment where three private agencies had failed.

Similar views were expressed by a collections branch chief in another ED regional office. Also, the collection staff in this region noted that the regional offices have in place debt collection units that they believe are more cost effective than private collection agencies.

In testimony before the House Subcommittee on Postsecondary Education, the Secretary of Education noted that amounts collected by ED have increased from about $9 million in fiscal year 1977 to almost $38 million in fiscal year 1980 and that ED collections are returning $3 to the Federal Treasury for every $1 in collection costs. The Secretary in his March 18 memorandum stated that ED has established an impressive record in the collections area and Federal collectors have proved to be very efficient.

In addition, NDSL monthly collection reports showed that during March 1981 ED's 10 regional offices reported collections totaling about $818,000. By comparison, in December 1980 collections totaled about $419,000. Through March 1981 ED regions collected about $5.8 million, an increase of about $2 million since December 1980. The following table shows collections for the five ED regional offices having the largest defaulted loan portfolios.

Region	Amounts collected		
	Dec. 1980	Jan. 1981	Mar. 1981
A	$133,423	$139,096	$171,334
B	52,214	56,373	99,261
C	40,685	51,923	134,887
D	45,616	70,290	144,128
E	33,746	66,693	92,905
	$305,684	$384,375	$642,515

ED's current plan for collecting defaulted student loans contemplates using private collection agencies to supplement a substantially reduced ED staff. In a February 23, 1979, 1/ report to the Congress, we had taken the position that the Government did not have the authority to hire private collectors except where the Congress provided specific authority. The 1976 Education Amendments (Public Law 94-482) provided ED such authority. In our February report, we pointed out that there could be merit in using private debt collectors to collect debts which were not economical for Federal agencies to pursue--those which have been administratively written off without pursuing legal action.

Further study of this issue in the following months resulted in amendment to the Federal Claims Collection Standards on April 17, 1981, to allow agencies to use private collectors, subject to certain limitations and guidelines. Under the amended Federal Claims Collection Standards, agencies must retain ultimate responsibility for debt collection activities, including discretion to determine when claims should be compromised or collection action otherwise terminated. The amendment does not prescribe the precise scope of authority that agencies should delegate to private collectors.

Before the amendment, an agency that had completed the various collection steps required by the Federal Claims Collection Standards or by its own regulations, could only write off an uncollected debt or refer it for legal action, depending on the size of the debt and prospect that legal action would be successful. The amendment now provides a third option--continuing collection action through private collection agencies. The amendment does not preclude agencies from contracting before exhausting required collection procedures when there is assurance that the required procedures would be carried out by the contractor. Agencies are ultimately responsible for determining the extent to which contracting out is appropriate. The standards provide for using private collection agencies where it is cost effective and otherwise practical.

1/Ibid, p. 13.

CONCLUSIONS

Presently, schools are precluded by law from assigning defaulted loans to ED for collection unless they have been in default for 2 years. If, as indicated by some ED collection officials, sending loans to ED sooner might increase chances for collection, schools should be allowed to submit loans to ED as soon as possible after complying with ED's prescribed loan collection procedures. To help in this matter ED should explore the need for an amendment to the statutory time limit for loan submissions.

ED's task force study and its contracted study contend that the use of private agencies would be as cost effective as ED's effort, but the statistics contained in the reports do not conclusively support that contention. In fact, cost data contained in the contracted study indicates that collection efforts in one ED region were clearly outstanding and could not be duplicated by a private contractor.

Some ED regional officials have raised concern over the studies and believe that private collectors will not be as cost effective as Federal collectors. This issue has not been resolved.

RECOMMENDATION TO THE SECRETARY OF EDUCATION

To strengthen the management of the NDSL program and help reduce its default rate, we recommend that the Secretary determine whether submissions of NDSLs to ED for collection earlier than the statutory 2-year time limit would be beneficial to collection efforts and, if so, propose legislation to allow schools to submit defaulted loans as soon as possible after completion of required collection activities.

Also, we recommend that the Secretary monitor ED's use of private collection agencies to insure that their use is the most cost-effective means of collecting defaulted student loans; any reassessment should consider the collection program that was in place in one ED region that was returning approximately $6 for every $1 spent.

AGENCY COMMENTS AND OUR EVALUATION

Allow schools to submit defaulted loans to ED before the 2-year time limit

ED said that the statute governing assignment of NDSL notes would be amended so that institutions may assign defaulted loans to the U.S. Government after they have performed all of the collection activities required by law and regulations.

Reassess the economic feasibility to use private collection agencies

In a draft of this report we proposed that ED reassess the economic feasibility of its plan to use private collection agencies to insure that their use is the most cost-effective means of collecting defaulted student loans. We pointed out that any reassessment should consider the potential of agencywide application of the collection program presently in place in one region (San Francisco) that is returning $6 for every $1 spent. ED stated that its decision to seek assistance from private collection firms was made in a manner fully consistent with present statutory and regulatory provisions relating to the use of such services. ED added that it contacted the Office of Management and Budget (OMB) about the necessity for conducting a formal cost analysis as required by OMB Circular A-76 and was informed by OMB that such an analysis was not required.

ED stated that it reviewed the best available evidence related to the use of private collection agencies (i.e., the contracted study discussed on p. 24) which showed that private sector pilot projects were performing efficiently and effectively. ED further stated that there were a number of factors which could not be quantified in the analyses but which it believed strongly favored the private sector option and would swing the cost comparison in the private sector's favor. ED added that two of the more significant factors were (1) the private contractors were working accounts that had already been unsuccessfully worked by Federal collectors and (2) the cost of the private collectors was inflated because, at the time the cost comparisons were made, the cost of the private sector projects included startup costs.

ED noted that, since there was generally no significant difference between the cost of using Federal collectors or private contractors to collect loans, the burden of proof is placed on those who argue for keeping this function in the public sector. ED added that it plans to examine the performance of the San Francisco regional office staff in an attempt to determine whether there really is a significant cost difference.

We believe that Federal agencies have the ultimate responsibility for determining the extent to which contracting with private collection agencies is appropriate. As noted on page 27 of this report, an April 17, 1981, amendment to the Federal Claims Collection Standards now allows agencies to use private collection agencies when "it is cost effective and otherwise practical." While ED's decision to use private collection agencies was based on the "best available evidence" as ED pointed out, that evidence did not conclusively show that private collection agencies are more efficient or effective than Federal collectors.

Because ED intends to award a collection contract soon, it may not be practicable to perform a detailed cost assessment before the contract is awarded. ED, however, should monitor the performance if its collection contractors to insure that the collection of defaulted loans is being carried out in a manner that will return the most Federal dollars at the least cost to the Government.

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