



Testimony

Before the Subcommittee on Higher Education and Workforce Training,
Committee on Education and the Workforce, House of Representatives

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FEDERAL STUDENT LOANS

Oversight of Defaulted Loan Rehabilitation Needs Strengthening

Statement of Melissa Emrey-Arras, Director,
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Chairwoman Foxx, Ranking Member Hinojosa, and Members of the Subcommittee:

I am pleased to be here today to discuss our work examining the Department of Education's (Education) efforts to rehabilitate defaulted federal student loans. As of September 2013 about \$94 billion—over 11 percent of federal student loan volume in repayment—was in default.¹ Loan rehabilitation allows borrowers who make nine on-time monthly payments within 10 months to have the default removed from their credit reports.² Education contracts with collection agencies to assist borrowers with rehabilitation and other options for repaying defaulted student loans. The federal government has an interest in ensuring that the loan rehabilitation process works well given the potential savings from returning defaulted loans to repayment. However, when Education upgraded its defaulted loan information system in October 2011, there were reports that some loans remained in default after borrowers had made enough payments to rehabilitate the loans, raising questions about Education's ability to manage the loan rehabilitation program.

You asked us to examine Education's rehabilitation of defaulted student loans. My remarks today will address the following two areas and is based on our report, which is being released at this hearing: (1) how the upgrade of Education's defaulted loan information system affected loan rehabilitation; and (2) how Education oversees collection agencies in implementing loan rehabilitation.³

In conducting this work, we focused our review on loans included in Education's defaulted loan information system.⁴ We reviewed Education's policies, procedures, and guidance; contracts and monitoring records for Education's system contractor and 22 collection agencies; fiscal year 2011-2013 collections and rehabilitation data; and relevant federal laws and regulations. We interviewed officials from Education, its defaulted

¹Default generally occurs when a borrower fails to make a payment for more than 270 days. 20 U.S.C. § 1085(l); 34 C.F.R. §§ 682.200(b) and 685.102(b).

²20 U.S.C. §1078-6(a)(1)(A); 34 C.F.R. §§ 682.405(a)(2) and 685.211(f)(1).

³GAO, *Federal Student Loans: Better Oversight Could Improve Defaulted Loan Rehabilitation*, [GAO-14-256](#) (Washington, D.C.: Mar. 6, 2014).

⁴According to Education, this includes about \$55 billion in Direct and Federal Family Education Loan program loans held by the department.

student loan system contractor, and borrower advocacy and consumer protection groups. We also conducted site visits to a nongeneralizable sample of 6 collection agencies, based on factors such as loan volume and geographic location. Our work was performed in accordance with generally accepted government auditing standards.

Limited Planning and Oversight of Education's Defaulted Loan Information System Upgrade Adversely Affected Loan Rehabilitation

Because of limited planning and oversight, Education was unable to provide most borrowers who completed loan rehabilitation with timely benefits for more than a year following the October 2011 upgrade of its defaulted loan information system. As a result, borrowers who made a good faith effort to rehabilitate their loans experienced delays in having the defaults removed from their credit reports and reinstating their federal student aid eligibility.

Education reported that the original information system, which had been in place since 1989, had become costly to maintain and many manual workarounds had been developed over the years to address emerging requirements. Education officials said it was also necessary to upgrade the system to handle the increased loan volume that the department was responsible for servicing.⁵ Education invited six firms, including the original system contractor to submit proposals for upgrading the system in 2009. The original contractor subsequently offered to upgrade the system at no additional cost to the government. In June 2010, Education canceled the request for proposals and modified the original contract to include the upgrade. The contract addresses the management of student loans, including loan servicing, which involves tracking loans and accepting payments from borrowers. The modification also guaranteed the contractor a minimum of 5 million non-defaulted borrowers to service through the end of the contract. Education officials said that their decision was based on the contractor's experience with the original system, its proposal to develop the upgrade in 6 months, the ease of upgrading

⁵Education expected increased loan volume following passage of the Ensuring Continued Access to Student Loans Act of 2008, which provided the department with the authority to purchase or enter into commitments to purchase Federal Family Education Loans (FFEL) from lenders and secondary markets to help ensure continued access to federally guaranteed student loans in the wake of the economic downturn. Pub. L. No. 110-227, § 7, 122 Stat. 740, 746. Further, Education anticipated an increase in the number of borrowers with Direct Loans, from about 7 million borrowers to about 13 million borrowers, due to the SAFRA Act, which terminated the authority to make or insure new FFEL loans after June 30, 2010. Pub. L. No. 111-152, § 2201, 124 Stat. 1029, 1074 (2010).

through an existing contract, and the contractor's willingness to perform the work at no additional cost to the government.

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

Table 1: Risk Factors Associated with the Defaulted Student Loan System Upgrade

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

Source: GAO analysis of Education documentation.

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

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

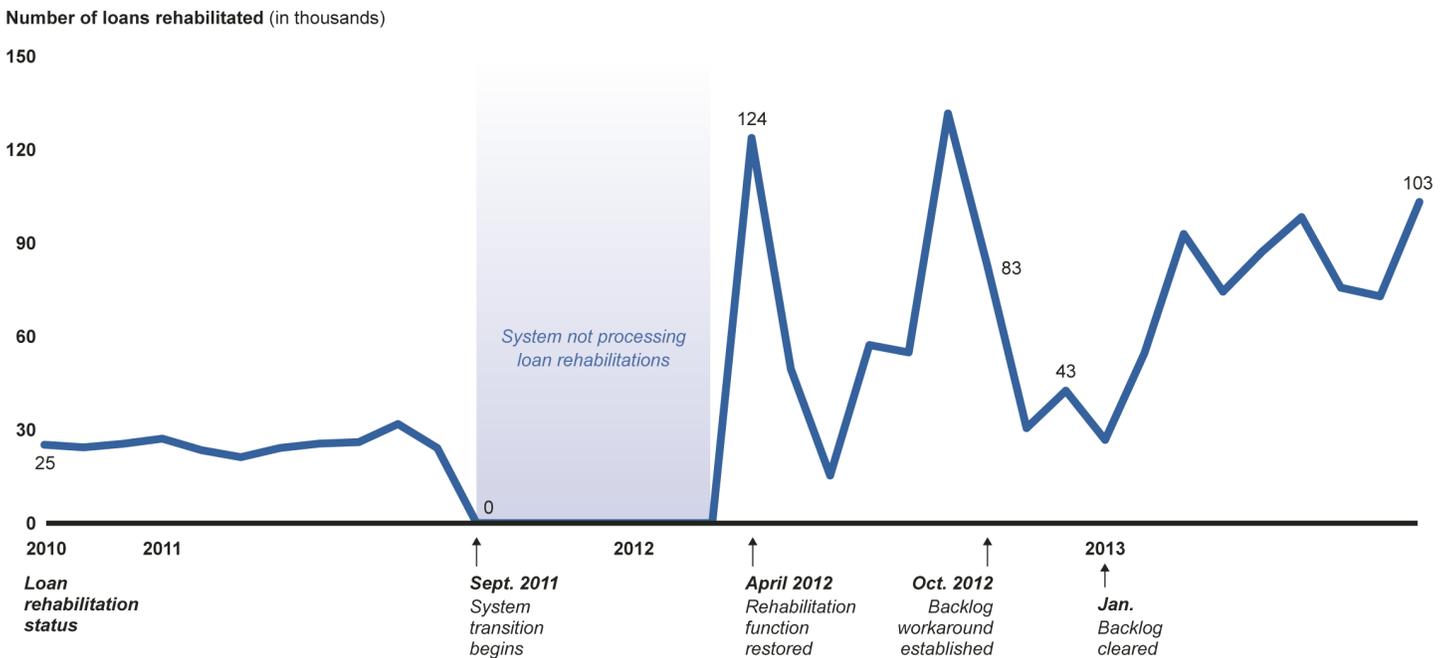
Despite these risks, Education did not have plans in place for monitoring the upgrade, and we found limited evidence of oversight conducted. Although Education officials acknowledged the monitoring plan for the original system contract was not relevant for overseeing the upgrade work, Education did not update it until 2011, about a year after the upgrade work began and performance problems, such as missed deadlines, had occurred. Education officials also acknowledged that they did not document many of their monitoring activities. In our review of contract files from May 2007 through December 2012, we found emails in which Education officials questioned the contractor's justifications for

specific tasks in their proposals. However, we did not find required documentation of status reports, deliverables received, or plans for addressing upgrade-related problems.

Moreover, we found the department’s testing of the new information system, which began in February 2011, was insufficient to detect problems associated with loan rehabilitation. For example, Education did not learn until shortly after the launch that the system did not recognize when borrowers had made nine on-time payments in 10 months because it did not test this function. Officials explained that testing in a 7-month time frame did not allow loan rehabilitation to be fully tested.

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

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



Source: GAO summary of Education data.

Education worked with the contractor to identify and correct the problems and took some steps to hold the contractor accountable and assist borrowers.

- **Efforts to hold the contractor accountable.** While the system upgrade was completed at no additional cost to the government, the contractor also provided other services under the contract, such as loan servicing and providing Education with access to its data centers. In September 2011, Education began assessing the contractor financial penalties due to implementation delays. In February 2012, when the problems were still not resolved, Education notified the contractor via a cure notice that it could default on the contract unless adequate progress was made on the upgrade issues.⁶ As of November 2013, Education reported withholding approximately \$14 million from total payments to the contractor for other services rendered under the contract.⁷
- **Efforts to assist borrowers.** Education established procedures in November 2011 to assist eligible borrowers by removing defaults from their credit reports or reinstating their eligibility for student aid. However, borrowers had to contact the department or their collection agency to receive the assistance. Officials said they provided such benefits to about 7,600 borrowers—less than 10 percent—of the estimated 80,000 borrowers who were affected during the time the system was not processing rehabilitations.⁸ Education officials said they did not systematically track when assistance was provided, and these rehabilitations were not processed through the system until April 2012 or later.

⁶A cure notice informs the contractor that the government considers the contractor's failure to make progress as endangering performance of the contract or the contractor has failed to perform contractual provisions other than delivery of supplies or performance of services. The cure notice specifies a period (typically 10 days) for the contractor to remedy the condition. If the condition is not corrected within this period, the cure notice states that the contractor may face termination of its contract for default. 48 C.F.R. § 49.402-3.

⁷Education documented the settlement agreement it reached for withholding payments from the contractor based on implementation delays in a December 2012 contract modification.

⁸Education processed about 20,000 to 30,000 loan rehabilitations a month in fiscal year 2011, prior to the upgrade. While Education was not able to track loan rehabilitations by borrower prior to the upgrade, officials said they have estimated that borrowers who use loan rehabilitation typically have two to three defaulted loans.

When Education's upgraded information system began processing loan rehabilitations in April 2012, the system still did not always recognize that eligible accounts had satisfied the requirements for loan rehabilitation. As a result, Education had to implement system workarounds and begin manually processing loan rehabilitations. While Education officials reported they stopped using manual processing in September 2013, they acknowledged that the system still requires workarounds and a substantial amount of development work will need to be completed to address remaining issues. Education expects the work to be completed under a new contract, which was awarded in September 2013. The system challenges the new contractor will be expected to resolve provide a compelling case for Education to strengthen its oversight. Without incorporating a risk-based approach to oversight into its planning for systems contracts and modifications, the department may continue to receive products and services that are delivered late and of unacceptable quality.

We also found that Education lacks data and related performance measures to inform its management and oversight of loan rehabilitation. According to The Office of Federal Student Aid's Fiscal Year 2011-2015 Strategic Plan, Education needs to be able to collect, analyze, and use customer data to achieve its goals of providing superior service and information to students and ensuring program integrity and safeguarding taxpayers' interests. Education reported rehabilitating about 600,000 loans for 200,000 borrowers from April 2012 to January 2013, as it worked to address the backlog of loan rehabilitations. However, Education has not developed performance data to assess the number or extent of individual borrower delays, or the extent to which borrowers who rehabilitate their loans stay out of default. Without such data and related performance measures, Education cannot assess its performance in serving borrowers or how effective rehabilitation is in minimizing the risk of defaulted loans to the federal government.

To address these issues, we recommended that Education strengthen its oversight by:

- developing an approach for tracking loan rehabilitation performance; and
- taking steps to ensure that the final monitoring plan for the new defaulted loan information system contract identifies risks and the oversight activities planned to address them.

Education concurred with the recommendations and highlighted actions it is taking in response to them. For example, Education stated that it has begun developing additional metrics for overseeing loan rehabilitation performance, and that it has established a monitoring plan for the new system contract that tracks key risk areas and identifies risk mitigation strategies.

Oversight Weaknesses Reduce Education's Ability to Effectively Monitor Collection Agency Performance

We also found that key weaknesses reduce Education's ability to effectively monitor collection agency performance and ensure borrowers receive accurate information about loan rehabilitation. While Education's monitoring procedures call for quarterly reviews of each collection agency's phone conversations with borrowers, we found Education had not consistently completed such call reviews. For example, we examined call review reports issued between September 2011 and March 2013 for the six collection agencies we visited; however, Education was unable to provide documentation for 11 of the 42 call reviews that should have been performed. Education officials said the reviews may not have been completed due to competing priorities, such as needing to reassign staff to manually process loan rehabilitations following the system upgrade.

The call review reports we examined documented a range of errors for each of the six collection agencies we visited, including providing borrowers with inaccurate or misleading information about rehabilitation program requirements and options. Among other things, Education documented instances where collection agency representative(s):

- did not explain rehabilitation provisions such as the one-time opportunity to rehabilitate a loan, that payments must be made within 20 days of the due date to be considered on time, or options for obtaining a reasonable and affordable payment;
- continued to push loan rehabilitation after the borrower said he was unemployed and was unable to make payments; and
- provided false or misleading information, such as incorrectly telling borrowers that a down payment or debit card was required to rehabilitate a loan.

While Education provides feedback on the results of its call reviews to each collection agency, it does not ensure that collection agencies take corrective actions and does not systematically analyze the results over time or across collection agencies to inform its oversight activities. Without a systematic approach to monitoring the results of call reviews,

Education may be missing opportunities to target its oversight and improve program performance.

To address these issues we recommended that Education take steps to improve its collection agency call review process. Education concurred with the recommendation and stated that it is revising its procedures to improve documentation of corrective actions and developing a database to track collection agency errors and associated corrective actions.

In conclusion, the findings in our report highlight serious weaknesses in Education's management and oversight of the loan rehabilitation process. The substantial delays that many borrowers experienced getting their loans out of default are largely attributable to Education not providing oversight appropriate to the risks associated with the system upgrade. While Education took steps to process the backlog of loans eligible for rehabilitation, it does not have performance data to provide assurance that borrowers are no longer experiencing delays. In addition, Education's oversight of collection agencies provides little assurance that borrowers are provided accurate information about loan rehabilitation. Education has taken some steps to strengthen its oversight in response to our recommendations. However, given the preliminary nature of these efforts, it will be important to track how Education builds upon and sustains these actions over time to ensure it is providing appropriate levels of oversight.

Chairwoman Foxx, Ranking Member Hinojosa, and Members of the Subcommittee this concludes my statement. I would be pleased to respond to any questions that you or other Members of the Subcommittee may have.

GAO Contact and Staff Acknowledgments

For questions about this statement, please contact Melissa Emrey-Arras at (617) 788-0534 or emreyarrasm@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this statement. Individuals making key contributions to this statement include Debra Prescott, Assistant Director; Kurt Burgeson, Maria Gaona, Amy Moran Lowe, and Jason Palmer.

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