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Administration of the William D. Ford Federal Direct Loan Program

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Summary

The William D. Ford Federal Direct Loan (Direct Loan) program, authorized under Title IV, Part D of the Higher Education Act of 1965 (HEA), is the primary federal student loan program. It makes available loans to undergraduate and graduate students and the parents of dependent undergraduate students to help them finance postsecondary education expenses. As of the end of FY2016, there was approximately \$949.1 billion in outstanding Direct Loan program loans. Direct Loan program administrative expenses totaled approximately \$771 million in FY2016.

Under the Direct Loan program, the federal government essentially serves as the banker by providing loans to students and their families using federal capital and assuming the risk of loss against borrower default. In addition, the federal government, via the U.S. Department of Education's Office of Federal Student Aid (FSA), manages the outstanding loan portfolio and is responsible for the program's administration. FSA is primarily responsible for developing the administrative functions and processes and performing oversight activities for the Direct Loan program to enable its day-to-day operation. Additional parties, including institutions of higher education (IHEs), contracted loan servicers, and contracted private collection agencies (PCAs), perform many of the routine administrative tasks for the program.

The first step in administering a Direct Loan is processing a student's Free Application for Federal Student Aid (FAFSA). After a student has completed his or her FAFSA, FSA's automated systems process the application and make an initial determination regarding a student's eligibility for federal student aid. IHEs then receive the processed information and take a variety of steps to award financial aid, including Direct Loans, to the student. Steps taken by the IHE at this point include packaging available aid for the student, originating and disbursing any Direct Loans the student is eligible for and has accepted, and managing Direct Loan program funds available to the institution.

After a borrower's Direct Loan is disbursed, the loan is then assigned to one of multiple loan servicers with which FSA has contracted. Functions performed by loan servicers vary depending on the loan's status (e.g., repayment, grace period) and individual borrower circumstances; however, there are several tasks loan servicers typically perform. These include providing information to borrowers on loan terms and conditions, collecting and applying loan payments to outstanding balances, processing requests for loan deferment or forbearance, processing applications to consolidate federal student loans into a Direct Consolidation Loan, and providing delinquency and default prevention activities.

If a borrower defaults after entering repayment on a Direct Loan, then a variety of actions may be taken to attempt to reinstate the loan into good standing and recover payment on it. Loan servicers provide initial outreach to defaulted borrowers and attempt to enter into repayment or rehabilitation agreements with them. If the loan servicer is unsuccessful, a borrower's defaulted loan is transferred to FSA and then may also be transferred to one of multiple PCAs with which FSA has contracted. FSA and PCAs will attempt to enter into voluntary repayment agreements with borrowers; however, a variety of other debt collection tools may also be used if these attempts are unsuccessful. For instance, a borrower may be determined eligible for administrative wage garnishment or income tax offset. If a borrower successfully brings his or her loan into good standing, the account is transferred back to a loan servicer, which will continue to service it.

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Introduction

The William D. Ford Direct Loan (Direct Loan) program is authorized under Title IV, Part D of the Higher Education Act of 1965 (HEA) and is the primary federal student loan program. It makes available loans to undergraduate and graduate students and the parents of dependent undergraduate students to help them finance postsecondary education expenses. Four types of loans are offered: Direct Subsidized Loans; Direct Unsubsidized Loans; Direct PLUS Loans; and Direct Consolidation Loans, through which borrowers may combine multiple loans into a single loan.¹ The Office of Federal Student Aid (FSA), within the U.S. Department of Education (ED), administers the Direct Loan program.² In total, ED manages an outstanding loan portfolio of approximately \$1.3 trillion, making it one of the largest financial institutions in the nation.³ Direct Loan program loans make up approximately \$963.5 billion (74%) of ED's loan portfolio.⁴

Prior to the establishment of the Direct Loan program, the primary federal student loan program was the Federal Family Education Loan (FFEL) program. Under the FFEL program, loan capital was provided to borrowers from private lenders and the federal government guaranteed lenders against loss through borrower default. FFEL program loans were originated by private lenders, and state and nonprofit guaranty agencies received federal funds to play the lead role in administering many aspects of the program, such as providing assistance in preventing delinquent borrowers from going into default.

Authorization for the Direct Loan program was enacted under the Student Loan Reform Act of 1993, part of the Omnibus Reconciliation Act of 1993 (P.L. 103-66).⁵ The program was established with the goal of streamlining the student loan delivery system. At that time, the FFEL program involved numerous parties from both the private and public sectors and concerns had arisen about the program structure being difficult to monitor and cumbersome to borrowers and schools.⁶ When enacted, the Direct Loan program was originally intended to gradually expand and replace the FFEL program; however, provisions calling for a full transition from the FFEL program to the Direct Loan program were repealed under the Higher Education Amendments of 1998 (P.L. 105-244). For nearly two decades, both the FFEL and Direct Loan programs operated simultaneously and institutions of higher education (IHEs) were able to participate in the program

¹ For additional information on Direct Loan program loans, see CRS Report R40122, *Federal Student Loans Made Under the Federal Family Education Loan Program and the William D. Ford Federal Direct Loan Program: Terms and Conditions for Borrowers*, by (name redacted).

² FSA also administers several smaller federal loan programs, including aspects of the Federal Family Education Loan program, the Federal Perkins Loan program, and the Health Education Assistance Loan (HEAL) program.

³ U.S. Department of Education, Office of Federal Student Aid, Federal Student Aid Data Center, *Federal Aid Portfolio Summary*, FY2017, Q4.

⁴ *Ibid.*

⁵ A Federal Direct Loan Demonstration program was enacted under the Education Amendments of 1992 (P.L. 102-325); however, prior to being fully implemented, the demonstration program was succeeded by the Federal Direct Student Loan program that was enacted under P.L. 103-66.

⁶ U.S. Congress, House Committee on the Budget, *Omnibus Budget Reconciliation Act of 1993*, report to accompany H.R. 2264, 103rd Cong., 1st sess., May 25, 1993, H.Rept. 103-111 (Washington: GPO, 1993), pp. 106-109. In 1993, among other program participants, there were 7,800 lenders and 46 guarantee agencies. It was estimated that converting to the Direct Loan program would generate approximately \$4.3 billion in savings over the five-year transition period from the FFEL program to the Direct Loan program and an additional \$2 billion each year after the Direct Loan program was fully implemented.

of their choice. In 2010, the SAFRA Act, part of the Health Care and Education Reconciliation Act of 2010 (P.L. 111-152), terminated the authority to make new FFEL program loans.⁷

Under the Direct Loan program, the federal government essentially serves as the banker by providing loans to students and their families using federal capital (i.e., funds from the U.S. Treasury). The federal government is also the owner of the loans and assumes the risk of loss through borrower default.

Although the federal government is the lender and owner of Direct Loans, several parties perform key functions in administering the program:

- **The Office of Federal Student Aid (FSA)**—FSA is a performance-based organization within ED that is the primary entity responsible for developing the administrative and financial management policies and functions for the federal Title IV student financial aid programs. FSA responsibilities are set forth in Section 141 of the HEA and include contracting for systems to support the programs; providing customer service, training, and user support for the administration of the programs; and ensuring the integrity of the programs.
- **Institutions of Higher Education**—IHEs involved in administering the Direct Loans are those schools at which students are using the program's loans to help finance their cost of attendance. IHEs help verify borrower eligibility to borrow Direct Loans, perform need analysis calculations and package student aid for current and prospective students, originate and disburse loans, report student enrollment information to ED, and make loan refunds to students and/or ED in specified situations.⁸
- **Loan Servicers**—Loan servicers are nonfederal entities that are hired as contractors to perform loan servicing, accounting, and delinquency processing work. Some of their key responsibilities include processing payments, communicating with borrowers about the status of their loans, and providing information about Direct Loan benefits and features (e.g., deferment and repayment plan options).
- **Private Collection Agencies (PCAs)**—PCAs are nonfederal entities that are hired as contractors to perform loan collection activities when borrowers default on their federal student loans. Some of their key responsibilities include locating and contacting delinquent borrowers and attempting to collect payment on defaulted loans.

This report discusses the major statutory and regulatory provisions and subregulatory guidance pertaining to the administration of the Direct Loan program. Although the administrative requirements for multiple Title IV student aid programs (e.g., Pell Grant) may be similar to or

⁷ Although the authority to make new FFEL program loans has been terminated, borrowers of FFEL program loans remain responsible for making payments on their loans, loan holders continue to be responsible for servicing the loans, and guaranty agencies continue to administer the federal loan insurance program. As of the end of FY2016, 16.4 million recipients had outstanding balances on FFEL program loans, totaling \$335.2 billion. U.S. Department of Education, Office of Federal Student Aid, Federal Student Aid Data Center, *Federal Aid Portfolio Summary*, FY2017, Q4.

⁸ IHEs must meet numerous criteria to participate in the Title IV student aid programs. These criteria include requirements related to an IHE's ability to provide the services described in its official publications and meet financial obligations, its educational program offerings, and its ability to properly administer the Title IV programs. For additional information on the requirements an IHE must meet to participate in the Title IV programs, see CRS Report R43159, *Institutional Eligibility for Participation in Title IV Student Financial Aid Programs*, by (name redacted).

overlap with Direct Loan program requirements, unless otherwise noted this report will only discuss such requirements in the context of the Direct Loan program.⁹ The report begins by outlining FSA’s broad role in developing administrative processes for the program. After that, it is organized in a manner that follows the “lifecycle” of a Direct Loan, highlighting key processes and parties involved in the various phases of the program’s administration. These phases begin when a student’s application for federal student aid is submitted and processed and continue through loan origination, disbursement, and repayment—and in some instances, default management. Processes, policies, and guidance related to the administration of the Direct Loan program are subject to regular change or adjustment; the descriptions herein are accurate as of the date of publication of this report.¹⁰

The Office of Federal Student Aid

The U.S. Department of Education’s Office of Federal Student Aid (FSA) is tasked with administering the Title IV federal student aid programs, including the Direct Loan program. Although FSA generally does not administer many of the day-to-day functions of the Direct Loan program (e.g., loan disbursement, loan servicing), it is responsible for implementing policies and procedures to enable them. This section of the report provides an overview of several duties FSA is responsible for carrying out to enable the operation of the Direct Loan program.

FSA as a Performance-Based Organization

FSA is specifically established as a performance-based organization (PBO) under Section 141 of the HEA. It was established in the Higher Education Amendments of 1998 (P.L. 105-244) as the federal government’s first PBO in response to the growing belief that ED needed restructuring to significantly improve the efficacy and efficiency of federal student aid delivery.¹¹

PBOs are intended to be results-driven organizations that have clear objectives and measurable goals intended to improve an agency’s performance and transparency. PBOs are led by chief executives who are personally accountable for meeting measurable goals within the organization. In exchange, PBOs are granted greater discretion to operate more like private-sector companies, with more control over budget, personnel decisions, and procurement.¹²

FSA operates as a discrete management unit within ED. It is responsible for the administrative and oversight functions supporting the HEA Title IV federal student aid programs, but the Secretary of Education (the Secretary) retains responsibility for the development and promulgation of policies and regulations relating to the Title IV programs.¹³ FSA is subject to the

⁹ For detailed information on the administration of the Pell Grant and Veterans Education Benefits programs, see CRS Report R44088, *Comparison of Post-9/11 GI Bill® and Pell Grant Administration*, by (name redacted) .

¹⁰ This report, when appropriate, contains information found in subregulatory guidance and policies. Because the processes for ED to issue subregulatory guidance and policies are less formal than amending statutory and regulatory provisions, such guidance may be more readily subject to change. This report reflects publicly available subregulatory policies issued by ED as of the date of publication.

¹¹ CRS Report RL32098, *The Office of Federal Student Aid: The Federal Government’s First Performance-Based Organization*, by Charmaine Jackson (archived, available upon request).

¹² For instance, FSA’s Chief Operating Officer is authorized to determine the number of senior managers needed and to make appointments, without regard to the federal government’s competitive service rules.

¹³ Typically, this function is fulfilled by ED’s Office of Postsecondary Education.

direction of the Secretary, but the Secretary is required to consult with FSA's Chief Operating Officer (COO) in the development of regulations and policies relating to the Title IV programs.¹⁴

Hereinafter, the terms FSA and ED will be used interchangeably, unless otherwise noted.

Primary Functions

HEA Section 141(b)(2) describes the types of administrative functions for which FSA is responsible. They include the following:

1. collecting, processing, and transmitting data to federal student aid stakeholders (e.g., students, IHEs);
2. defining technical specifications for software development and procurement, acquiring software and hardware, and contracting for all information technology and financial systems related to the administration of Title IV student aid;
3. providing all customer service, training, and user support related to the administration of Title IV student aid; and
4. ensuring the integrity of the Title IV student aid programs.

The Secretary may also allocate additional functions to FSA as the Secretary and COO determine necessary and appropriate.¹⁵

Although FSA has many functions, this report will describe a few key ones as they relate to student aid delivery in general, and the Direct Loan program specifically. Specific functions to be discussed include FSA's procurement and operation of some of the various Title IV processing systems (e.g., the Central Processing System), FSA's contracting for student loan servicing, and FSA's Student Loan Ombudsman. Each function will be discussed in detail throughout the report when appropriate.

Student Loan Ombudsman

HEA Section 141 directs FSA's COO to appoint a Student Loan Ombudsman (the Ombudsman) to provide timely assistance to borrowers of Title IV loans. In doing so, the Ombudsman is tasked with reviewing and attempting to resolve informally borrower disputes with, as appropriate, IHEs, loan servicers, and other participants in the Title IV loan programs.¹⁶ For instance, the Ombudsman can help resolve discrepancies related to loan balances and payments; identify options to resolve borrower issues related to consolidation, service quality, default status,

¹⁴ HEA §141(a) & (b).

¹⁵ HEA §141(b)(3). This authority to allocate additional functions to FSA is separate from the Secretary's general authority to delegate tasks to ED offices and employees, as provided under section 412 of the Department of Education Organization Act (P.L. 96-88).

¹⁶ In addition, in July 2016 FSA launched the FSA Feedback System, which is an online portal that allows federal student aid customers to "submit complaints, provide positive feedback, and report allegations of suspicious activity regarding their experience with federal student aid programs." Policy Memorandum to James Runcie, Chief Operating Officer, Federal Student Aid, from Ted Mitchell, Under Secretary, U.S. Department of Education, "Policy Direction on Federal Student Loan Servicing," July 20, 2016, as updated October 17, 2016, <https://www2.ed.gov/documents/press-releases/loan-servicing-policy-memo.pdf>, p. 6. Although this policy memorandum was recently rescinded (U.S. Department of Education, "Memorandum from Secretary of Education Betsy DeVos to FSA Chief Operating Officer James Runcie Regarding Student Loan Servicer Recompete," press release, April 11, 2017, <https://www.ed.gov/news/press-releases/memorandum-secretary-education-betsy-devos-fsa-chief-operating-officer-james-runcie-regarding-student-loan-servicer-recompete>), the FSA Feedback System remains operational.

bankruptcy, and income tax refund offsets; explain loan interest and collection charges; and clarify requirements for loan deferment or forbearance and loan cancellation or discharge. The Ombudsman cannot, however, make binding decisions or overturn the decisions of other entities; accept complaints about grants, such as Pell Grants; or replace formal channels of dispute resolution within ED.¹⁷

Processing Applications and Awarding Aid

This section of the report discusses key aspects of Direct Loan program administration from the time students complete and submit the Free Application for Federal Student Aid (FAFSA) through the time that Direct Loans are disbursed to borrowers. The key parties involved in this phase of the process are the following:

- **FSA**, which develops and maintains the FAFSA, contracts for the operation and maintenance of information technology systems, and provides oversight of Title IV participating IHEs and third-party servicers;
- **IHEs**, which verify student eligibility for loans, assess students' levels of need for financial assistance and package financial aid, disburse funds (received from FSA) to students and parent borrowers, provide loan counseling to students, and periodically report to the National Student Loan Data System (NSLDS) to confirm students' enrollment/aid eligibility status; and/or
- **Third Party Servicers**, which may perform any or all of the administrative duties of an IHE as a contractor for it. Third-party servicers must agree to comply with all statutory and regulatory provisions applicable to the administration of the Direct Loan program.¹⁸ In many ways, third-party servicers' and IHEs' responsibilities with respect to administering the Direct Loan program may be similar or the same; thus, hereinafter this report will only refer to IHEs.

Applying for Title IV Student Aid

Students wishing to receive HEA Title IV student aid, including Direct Loans, must annually apply for assistance using the FAFSA. Income and personal information submitted via the FAFSA is used to determine an applicant's eligibility for Title IV aid and to calculate each student's expected family contribution (EFC). A student's EFC is a dollar amount that reflects the amount of financial resources that students and their families are expected to use to meet an IHE's cost of attendance. The EFC is used to determine the types and amount of student aid for which an individual may be eligible. FSA develops and maintains the FAFSA, in accordance with specifications set forth in the HEA.¹⁹

¹⁷ U.S. Department of Education, Office of Federal Student Aid, "Getting Prepared Before Seeking Help," <https://studentaid.ed.gov/sa/repay-loans/disputes/prepare/>, accessed May 10, 2017. For additional information on the Student Loan Ombudsman, see U.S. Department of Education, Office of Federal Student Aid, *Annual Report FY2015*, November 13, 2015, pp. 68-76.

¹⁸ HEA §487; 34 C.F.R. §668.25.

¹⁹ Specifically, HEA §§473-480 set forth most of the components of the EFC formula that are collected in the FAFSA. HEA §483 requires that ED produce and distribute the FAFSA to "determine the need and eligibility of a student for financial assistance [under Title IV]," and requires that the FAFSA be made available free of charge and in paper and electronic formats.

Individuals usually complete and submit the FAFSA online.²⁰ For academic year (AY) 2016 (i.e., July 1, 2016-June 30, 2017) and all preceding academic years, individuals use(d) income data from the previous tax year (commonly referred to as prior year, or PY) to complete the FAFSA. Thus, for AY2016 individuals use their tax year 2015 income information. In this situation, the processing cycle is 18 months, as students are permitted to submit the FAFSA as of January 1 of the initial year included in the award year for which the individual seeks aid through the end of the award year. For instance, in AY2016 an individual could have submitted a FAFSA as early as January 1, 2016, or as late as June 30, 2017.

Beginning in AY2017 (i.e., July 1, 2017-June 30, 2018), the FAFSA will be available three months earlier and individuals will be able to use income data from the tax year two years prior to the award year (commonly referred to as prior-prior year, or PPY) when completing the FAFSA.²¹ Thus, for AY2017 individuals will use their tax year 2015 income information. Under PPY, the FAFSA becomes available on October 1, three months earlier than it did under PY. To facilitate the use of PPY for AY2017, the FAFSA processing cycle will be 21 months; thus, an applicant may submit the FAFSA between October 1, 2016, and June 30, 2018.²² **Table 1** depicts the FAFSA processing cycle under PY and PPY.

Table 1. FAFSA Processing Cycle under Prior Year and Prior Prior Year

Academic Year for Which Aid is Sought	When FAFSA May Be Submitted	Required Tax Year Information
Prior Year		
July 1, 2015-June 30, 2016	January 1, 2015-June 30, 2016	2014
July 1, 2016-June 30, 2017	January 1, 2016-June 30, 2017	2015
Prior Prior Year		
July 1, 2017-June 30, 2018	October 1, 2016-June 30, 2018	2015
July 1, 2018-June 30, 2019	October 1, 2017-June 30, 2019	2016

Source: Table created by CRS based on analysis of the FAFSA for July 1, 2017-June 30, 2018, available at <https://studentaid.ed.gov/sa/sites/default/files/2017-18-fafsa.pdf>.

Processing the FAFSA

Both FSA and IHEs play significant roles in processing the FAFSA. FSA contracts for information technology systems that perform key FAFSA-processing functions, and IHEs then use the processed FAFSA data to verify student eligibility and determine a student's need for financial aid.

²⁰ Alternatively, students may submit the FAFSA by mail or IHEs may complete the FAFSA on behalf of students.

²¹ HEA §480(a)(1)(B) permits the Secretary of Education to use PPY "to the extent necessary to carry out the simplification of applications." The use of PPY was implemented to enable students to complete their FAFSA earlier than was possible using PY.

²² U.S. Department of Education, Office of Federal Student Aid, "Early FAFSA Electronic Announcement #1—President's Announcement of FAFSA Filing Changes," September 14, 2015, available at <http://ifap.ed.gov/eannouncements/091415PresidentAnnounceFAFSAFilingChanges.html>.

Central Processing System

After an aid applicant submits the FAFSA, the form is processed by the Central Processing System (CPS). The CPS is an automated system contracted by FSA to process the FAFSA and determine initial student eligibility for federal student aid and calculate a student's EFC. The CPS performs a variety of functions related to FAFSA processing, including the following:

- performing database matches to determine student eligibility for aid (e.g., match student information against the Social Security Administration database to confirm each student's social security number and U.S. citizenship status);²³
- interfacing with the Internal Revenue Service Data Retrieval Tool, which links students', students' spouses', and parents' Internal Revenue Service tax information to the FAFSA;²⁴
- calculating each student's EFC on the basis of financial information provided on the FAFSA;²⁵
- checking applications for potential inconsistencies and mistakes and selecting applications for verification of information; and
- making processed FAFSA information available to students and student-designated IHEs.²⁶

Institutions of Higher Education

After the CPS completes initial processing of the FAFSA, the processed information is made available to the student and student-designated IHEs in the form of a Student Aid Report (SAR) and Institutional Student Information Record (ISIR), respectively.²⁷ Upon receipt of the ISIR, an IHE may take a variety of steps before awarding federal student aid to an applicant, including verifying information provided on the FAFSA and using professional judgment to adjust data values provided on the FAFSA to respond to unusual student situations that cannot be fully anticipated in the statutes and regulations. The IHE then calculates the student's need for federal student aid and packages student aid awards.

²³ In total, the CPS performs matches against seven databases: the National Student Loan Data System (NSLDS), the Department of Defense, the Department of Justice, the Social Security Administration, the Department of Veterans Affairs, the Department of Homeland Security's database of noncitizens, and the Selective Service System registration database. U.S. Department of Education, Office of Federal Student Aid, *2016-2017 Federal Student Aid Handbook*, p. AVG-7 (hereinafter, *FSA Handbook*).

²⁴ Due to lack of data availability, not all FAFSA applicants are eligible to use the IRS Data Retrieval Tool (DRT). For instance, applicants who are married and filed their tax return as Married Filing Separately, are married and filed as Head of Household, or filed an amended tax return are not eligible to use the IRS Data Retrieval Tool. These applicants must enter their tax return information manually into the FAFSA. For a complete list of those applicants ineligible to use the DRT, see *FSA Handbook*, p. AVG-82.

²⁵ For information on how each student's EFC is calculated, CRS Report R44503, *Federal Student Aid: Need Analysis Formulas and Expected Family Contribution*, by (name redacted) .

²⁶ For a complete description of CPS components and functions, see Calvin Whitaker, *Privacy Impact Assessment for Central Processing System (CPS)*, U.S. Department of Education, March 25, 2013.

²⁷ The ISIR is also shared with state agencies. This information may then be used to determine an individual's eligibility for state aid. Many IHEs also use information on the ISIR to award institutional aid.

Verification

Verification is the process IHEs must use to review data reported on the FAFSA for accuracy and completeness. Annually, ED publishes in the *Federal Register* a list of potential FAFSA items IHEs may be required to verify for selected individual applications.²⁸ Typical items IHEs may need to verify include an applicant's adjusted gross income and household size, or whether the intended student has a valid high school diploma.

In some instances, the CPS selects specific items on an application for verification,²⁹ and in other instances, IHEs must verify specific items on applications they have reason to believe are inaccurate.³⁰ It is estimated that CPS annually selects one-third of all Title IV applicants for verification; the number of Title IV applicants selected for verification by IHEs is unknown.³¹ If an application is selected for verification, IHEs must request additional documentation from an applicant to resolve the issue.³² IHEs may not disburse or originate subsidized federal student aid³³ (e.g., Direct Subsidized Loan program loans, Pell Grants) before verification is completed if an IHE has reason to believe the applicant's FAFSA information is inaccurate.³⁴

IHEs may also establish additional verification requirements, regardless of whether they have reason to believe that an applicant's FAFSA is inaccurate.³⁵ In such situations, IHEs have discretion to withhold payment or origination of subsidized federal student aid from the applicant until verification is complete.³⁶

Awarding and Disbursing Aid

IHEs are the primary actors in this phase of Direct Loan program administration. After processing the FAFSA data, an IHE calculates the aid for which a student is eligible, packages student aid, makes specified disclosures to the borrower, disburses aid funds to the student, and completes reporting and follow-up activities as needed.

²⁸ 34 C.F.R. §668.56. U.S. Department of Education, "Free Application for Federal Student Aid (FAFSA) Information to be Verified for the 2018-2019 Award Year," 82 *Federal Register* 21204-21208, May 5, 2017.

²⁹ HEA §487A(a) authorizes ED to operate a Quality Assurance Program (QAP) under which IHEs voluntarily participate to develop and implement their own systems relating to processing and disbursing student aid, verification, and entrance and exit interviews to enhance the program integrity of the student aid delivery system. The Secretary may waive any regulations related to reporting or verification requirements for IHEs participating in the QAP. IHEs participating in the QAP are exempt from having to verify the records selected by CPS. For additional information, see U.S. Department of Education, Office of Federal Student Aid, "Quality Assurance Program," <https://ifap.ed.gov/qahome/Default.html>, accessed May 10, 2017.

³⁰ For instance, an IHE may have conflicting information regarding a student's eligibility for Title IV aid.

³¹ The Task Force on Federal Regulation of Higher Education, *Recalibrating Regulation of Colleges and Universities*, February 17, 2015, p. 130.

³² 34 C.F.R. §668.54(a)(1)-(2).

³³ Subsidized federal student aid is HEA Title IV programs for which eligibility is determined on the basis of an applicant's EFC. These programs include the Federal Pell Grant, Federal Supplemental Educational Opportunity Grant (FSEOG), Federal Work-Study (FWS), Federal Perkins Loan, and Direct Subsidized Loan program. 34 C.F.R. §668.52.

³⁴ 34 C.F.R. §668.58(a)(1).

³⁵ 34 C.F.R. §668.54(a)(3).

³⁶ 34 C.F.R. §668.58(a)(2).

Calculating and Packaging Direct Loans

After receiving the FAFSA data, an IHE calculates and determines the amounts and types of aid that will be offered to the student. This process is known as packaging. The packaging of federal student aid in general, and Direct Loans specifically, is guided by statutory eligibility requirements and award rules.

Beyond the basic Title IV eligibility requirements (e.g., U.S. citizenship or residency requirements), eligibility for many Title IV aid programs is contingent on student need. In general, student need is the difference between the cost of attendance (COA) and expected family contribution (EFC). Determining this need is known as need analysis.

Cost of Attendance

HEA Section 472 defines cost of attendance and lists numerous allowable costs IHEs may include in the COA for purposes of calculating a student's Title IV need. While the HEA provides a broad list of items to be included in an institution's COA—tuition and fees, books and supplies, room and board, and other expenses a student may face while enrolled, such as the cost of child care or transportation³⁷—individual IHEs determine the precise dollar amount for each of those items to be included in the COA. For instance, for the cost of room and board for students living off-campus, an institution may determine reasonable expenses based on rental market rates. Thus, expenses for room and board in an area with a high cost-of-living will likely be greater than they would be in a relatively less expensive area.³⁸

Expected Family Contribution

HEA, Title IV, Part F prescribes specific formulas used to determine a student's EFC. The EFC is an expression of the amount of financial resources that students and their families are expected to contribute to meet the cost of the student's postsecondary education. It is calculated using income and asset information provided on the FAFSA.

Determining and Packaging Types and Amount of Aid Available to Students

After a student's need has been calculated, IHEs' financial aid administrators (FAAs) then determine the types and amount of aid an IHE will offer a student. In all cases, an IHE must first determine whether a student is eligible for a Pell Grant and, if so, the amount of the grant. For purposes of other federal student aid programs, after a Pell Grant is awarded the amount of student need is decreased accordingly. Based on the remaining amount of need (known as "unmet need"), an IHE may then calculate amounts of other forms of student aid to offer a student.

The types and amount of student aid available to a student after his or her Pell Grant has been awarded depend on a variety of factors, including statutory and regulatory requirements and an IHE's own student aid packaging practices.³⁹ Although myriad factors could affect the final types

³⁷ Exceptions and variations to the general COA definition apply. For instance, IHEs may not include expenses for room and board in COA for students who are enrolled less than half-time.

³⁸ For additional information, see *FSA Handbook*, vol. 3, pp. 33-42.

³⁹ For instance, an IHE may determine to meet full student need by awarding a combination of federal student aid and institutional scholarships. 34 C.F.R. §§686.21(d) & 685.200(e).

of student aid offered, several statutory and regulatory provisions guide the packing of Direct Loans:⁴⁰

- Direct Loans (including Direct PLUS Loans), in combination with other aid (e.g., Pell Grants, institutional scholarships) cannot exceed the student's COA,
- an individual cannot be awarded a Direct Subsidized Loan or Direct Unsubsidized Loan in an amount that exceeds statutory annual and aggregate borrowing limits,
- an IHE must offer a student a Direct Subsidized Loan before it offers a Direct Unsubsidized Loan,
- an IHE must offer a graduate or professional student a Direct Unsubsidized Loan before it offers a Direct PLUS Loan,
- a student may not receive a Direct Subsidized Loan for a period that exceeds 150% of the published length of the academic program in which he or she is enrolled, and
- Direct Unsubsidized Loans and Direct PLUS Loans may be substituted for a student's EFC.⁴¹

Once an IHE has determined the types and amount of aid it will offer to a student, it then notifies the student of the financial aid package being offered. IHEs have the discretion to decide how they will notify students. For instance, the notification may be via a written letter or email.

Professional Judgment

HEA Section 479A provides that in special circumstances, FAAs may use professional judgment to make adjustments to certain data points used to determine a student's eligibility for Title IV aid and, thus, potentially affect the amount of aid for which a student is eligible. This authorization to use professional judgment is intended to enable FAAs to respond to situations that cannot be fully anticipated in the statutes and regulations. Professional judgment cannot, however, be used to waive general student eligibility requirements or circumvent the intent of the law or regulations. Each time an FAA uses professional judgment, the reason for its use must be documented. Any student aid adjustments are valid only at the IHE making the adjustments and for the award year in which they are made.⁴²

FAAs may, on a case-by-case basis, use professional judgment to make adjustments to the data values required to calculate the EFC or to adjust a student's COA.⁴³ In addition, another form of professional judgment is the dependency override, in which an FAA determines that an otherwise dependent student should be considered independent for Title IV purposes.⁴⁴ In any of these

⁴⁰ For additional information, see *FSA Handbook*, vol. 3, pp. 87-132.

⁴¹ That is, rather than requiring a student or his or her family to meet the EFC out-of-pocket, IHEs may permit individuals to use these aid types (along with TEACH Grants and private education loans) to meet the EFC instead.

⁴² For additional information on when professional judgment may be used, see *FSA Handbook*, pp. AVG-119 through AVG-123.

⁴³ HEA §479A(a) provides a list of special circumstances under which professional judgment might be used. Such circumstances could include medical expenses not covered by insurance or unusually high dependent care costs.

⁴⁴ A dependency override may only be used in unusual circumstances, such as abandonment by parents or an abusive family environment. Unusual circumstances do not include circumstances such as parents' refusal to contribute to the student's education or the student's demonstration of self-sufficiency.

instances, the use of professional judgment may increase or decrease a student's eligibility for federal student aid.

Accepting Aid

To accept and subsequently receive disbursements of a Direct Loan from an IHE as presented in the financial aid package, a borrower must sign a master promissory note (MPN). The MPN is a legal document containing the terms and conditions of the loan and under which a borrower agrees to repay the loan. Loan terms and conditions contained in the MPN include items such as deferment and forbearance options, potential loan discharge (forgiveness) benefits, and the consequences of defaulting on a loan. Loan terms and conditions are specified in statute and regulations.⁴⁵

Under HEA Section 432, FSA is required to develop, and IHEs are required to use, the MPN. IHEs can choose to use MPNs with a multi- or single-year feature. IHEs that use the single-year MPN may only make loans under the MPN for one academic year.⁴⁶ IHEs that use the multiyear MPN may make one or more Direct Loans to borrowers for multiple award years for up to 10 years.⁴⁷ That is, once a multiyear MPN has been signed by a borrower and accepted by FSA, IHEs are not required to obtain a new MPN for each academic year for which the individual wishes to borrow.⁴⁸ However, IHEs that use the multiyear MPN must develop a process for borrowers receiving loans for a subsequent academic year to confirm their acceptance of a new Direct Loan in subsequent years.⁴⁹

Origination

If a student accepts a Direct Loan, an IHE may then originate it. Origination is the process through which an IHE submits information to FSA regarding a borrower's eligibility for a Direct Loan and requests Direct Loan funds on behalf of a student. After an IHE has confirmed that a potential borrower remains eligible (e.g., determining that the student is enrolled at least half-time and ensuring the loan amount to be borrowed does not exceed annual and lifetime borrowing limits),⁵⁰ it must submit the information related to the student's eligibility, loan period, anticipated disbursement dates, and disbursement amounts to FSA's Common Origination and Disbursement (COD) system, which then processes, accepts, edits, or rejects the records. COD is an FSA system to which IHEs have access in order to request, report, and reconcile Title IV funds.

⁴⁵ See U.S. Department of Education, "Master Promissory Note, William D. Ford Federal Direct Loan Program," OMB No. 1845-0007.

⁴⁶ 34 C.F.R. §685.102.

⁴⁷ Foreign IHEs are not permitted to use a multiyear MPNs. U.S. Department of Education, Office of Federal Student Aid, "Direct Loan 101—Master Promissory Notes," May 11, 2016.

⁴⁸ Borrowers may notify an IHE or servicer in writing that they no longer wish to receive new loans under the multiyear MPN.

⁴⁹ For Direct Subsidized Loans and Direct Unsubsidized Loans, IHEs may use an active or passive confirmation process. In an active confirmation process, an IHE obtains written confirmation from a borrower that he or she wishes to accept the loan. In a passive confirmation process, the borrower only needs to notify the IHE if he or she is declining the loan in whole or in part. For Direct PLUS Loans, an IHE must use an active confirmation process. 34 C.F.R. §668.165(a).

⁵⁰ HEA §454(b)(2). Because IHEs, and not FSA, ultimately determine a borrower's eligibility for a Direct Loan, IHEs that originate and disburse loans to ineligible borrowers or for amounts that exceed a borrower's need or loan limits are liable for repayment of the loan to the government, plus interest and costs the government paid on the ineligible loans. Additionally, an IHE may be subject to an administrative action such as a fine, limitation, suspension, or termination of Title IV participation. HEA §454(a)(3) and *FSA Handbook*, vol. 3, p. 90.

After COD accepts origination records, an IHE may then request funds for a student, based on the amount of Direct Loan for which the student is eligible,⁵¹ from FSA's G5 system. The G5 system provides funding authorizations to IHEs and enables them to draw down Title IV funds from ED to disburse to borrowers.

Professional Judgment

Under HEA Section 479A, an FAA may use professional judgment to either refuse to originate a loan or to originate a loan for less than the student's maximum eligibility.⁵² For example, an FAA may refuse to originate a loan if the FAA has reason to believe that the borrower will be unable to repay the loan due to a high amount of debt.⁵³ These professional judgments must be made on a case-by-case basis and the reasons for making them must be documented and provided to the student.⁵⁴

Disclosures and Entrance Loan Counseling

Before an IHE may provide Direct Loan funds to borrowers, it must first make a variety of disclosures to them, and for certain borrowers, it must provide entrance loan counseling.

Disclosure Statement

In general, prior to disbursing any form of Title IV federal student aid to a borrower, an IHE must disclose to the student the amount of funds he or she (or his or her parents in the case of Direct PLUS loans) can expect to receive and how and when those funds will be disbursed.⁵⁵ For Direct Loans, the notice must also inform the borrower of which funds are from subsidized loans and which are from unsubsidized loans, and their right to cancel all or a portion of the loan and the procedures to do so.⁵⁶

⁵¹ An IHE may not originate a loan for more than the borrower's COA, annual or aggregate loan limits, unmet financial need, or amount the borrower requested. However, an IHE may substitute certain types of Title IV aid (i.e., Direct Unsubsidized Loans, TEACH Grants, and PLUS Loans) and nonfederal, non-need-based aid (e.g., institutional loans) for a student's EFC. See 34 C.F.R. §§685.200 & 685.203.

⁵² Additionally, if a student's determined need for a Direct Subsidized Loan is \$200 or less, an IHE may choose not to originate the Direct Subsidized Loan and may include the amount in a Direct Unsubsidized Loan. 34 C.F.R. §685.301(a)(7).

⁵³ For examples of limitations to this professional judgment, see U.S. Department of Education, Office of Federal Student Aid, GEN-11-07, "Guidance on Participation in the William D. Ford Direct Loan (Direct Loan) Program," March 22, 2011, available at <https://ifap.ed.gov/dpclatters/GEN1107.html>.

⁵⁴ An FAA cannot make such professional judgments in a manner that constitutes a pattern or practice that denies access to student aid based on race, sex, color, income, religion, national origin, age, or handicapped status.

⁵⁵ This notice must include all federal funds that a borrower can expect to receive, including, for example, Pell Grants and Federal Work-Study.

⁵⁶ 34 C.F.R. §668.165(a)(2)-(3). Some IHEs require students to affirmatively confirm their acceptance of a Direct Loan (i.e., written confirmation) that they want for the award year before the IHE credits their student accounts with those funds. Other IHEs do not require such affirmative confirmation before crediting a student's account. In either event, IHEs must provide notification to students of their right to cancel all or a portion of the loan and the procedures to do so, and loans may be cancelled after a student's account has been credited with loan funds. The timeframes of the pre-disbursement notification and a student's cancellation of a loan depend on whether a student affirmatively confirms their acceptance of the loan.

Plain Language Disclosure

In addition to the disclosures that all IHEs are required to provide borrowers prior to making disbursements, IHEs using a multiyear MPN are required to make disclosures to borrowers relating to various aspects of Direct Loans at or prior to the disbursement of any subsequent loans made under the multiyear MPN. This disclosure is known as the Plain Language Disclosure (PLD), which is developed by FSA.⁵⁷ Information provided in the PLD includes items related to the loan terms and conditions, such as amount borrowed, interest rate, and any charges (e.g., origination fee) associated with the loans; a statement of the total cumulative balance owed by the borrower and projected monthly payments; and a definition of default and its consequences.⁵⁸ IHEs using a single-year MPN are not required to provide the PLD to borrowers, because borrowers are required to complete a new MPN for each subsequent loan period and the MPN contains the loan terms and conditions.

Entrance Counseling

Prior to making the first disbursement on a Direct Subsidized Loan or Direct Unsubsidized Loan to first-time borrowers⁵⁹ or the first disbursement on a Direct PLUS Loan to first-time graduate and professional student borrowers, an IHE is required by HEA Section 485(l) to ensure that the borrower receives entrance counseling.⁶⁰ The information provided in entrance counseling generally relates to loan terms and conditions and borrower rights and responsibilities, which includes the following:

- the effect of accepting the loan on the eligibility of the borrower for other forms of student financial assistance,
- an explanation of the MPN,
- information on how interest accrues and is capitalized,
- sample monthly repayment amounts based on a range of levels of indebtedness and the average cumulative debt of other borrowers in the same program as the borrower at the same IHE,
- the obligation of the borrower to repay the loan in full, and
- the likely consequences of default.

⁵⁷ An IHE may opt to have COD send the disclosures directly to the student or to send the disclosures to the student itself. U.S. Department of Education, Federal Student Aid, *Direct Loans 101—Direct Loan Overview*, March 1, 2016, pp. 5-6.

⁵⁸ HEA §§433(a) & 455(p). Additionally, under HEA §485(a), IHEs are required to disseminate a variety of institutional information to current and prospective students, such as the cost of attendance and the names of associations or accreditation agencies that accredit the institution. Under the gainful employment requirements, IHEs are also required to disclose a variety of information related to their gainful employment programs, including median loan debt and job placement rates of program completers. 34 C.F.R. §668.6. A full listing of such disclosure requirements are beyond the scope of this report. For additional information on institutional disclosure requirements, see *FSA Handbook*, vol. 2, pp. 109-138.

⁵⁹ A first-time borrower is defined as one who has not previously received a Direct Subsidized Loan or Direct Unsubsidized Loan, an FFEL Stafford Loan, or Supplemental Loan for Students (SLS) program loan. FFEL Stafford Loans and SLS program loans are no longer being disbursed.

⁶⁰ As of March 29, 2015, special loan counseling is required for any PLUS loan applicant, including parents, who has an adverse credit history but who qualifies for a PLUS Loan. 34 C.F.R. §685.200(c)(2)(vii)(A)(3) and U.S. Department of Education, Office of Federal Student Aid, “Early Implementation of Changes in Regulations on Adverse Credit History Under the Direct PLUS Loan Program,” electronic announcement, January 27, 2015.

IHEs can include additional information, materials, and resources in the entrance counseling⁶¹ but cannot require borrowers to complete additional counseling (other than exit counseling in certain circumstances).

An IHE may use FSA's online counseling tool, which includes the required counseling components and assists IHEs in keeping track of those borrowers who have completed the counseling.⁶² Alternatively, IHEs may develop their own entrance counseling, which can be delivered in a variety of ways—such as online, in-person, by audio/visual means, or with the use of worksheets and exercises—so long as it contains the required counseling components.

Disbursement

Disbursement is the process of distributing aid to or on behalf of a borrower. In addition to completing the verification process described earlier in this report, IHEs must determine and document whether a borrower remains eligible to receive aid funds (e.g., confirm that the student is enrolled in classes for the period).⁶³

After the student's eligibility is confirmed, an IHE then disburses funds. It may do so by either crediting a student's institutional account for allowable charges (e.g., tuition and fees) or paying the student (or parent borrower)⁶⁴ directly. Typically, IHEs choose to first credit Title IV funds to a student's institutional account and then disburse the balance of the funds to the student or parent borrower.⁶⁵ To disburse funds directly to a borrower, an IHE may issue a check, initiate an electronic funds transfer,⁶⁶ or pay in cash.

⁶¹ Any additional information provided to borrowers must be "reasonable as to time, effort, and relevance to the students' borrowing decisions and may not be administered in a way that unreasonably impedes their ability to borrow." *FSA Handbook*, vol. 2, pp. 132-134.

⁶² For additional information on FSA provided entrance counseling, see federal Student Aid, "Entrance Counseling," at <https://studentloans.gov/myDirectLoan/entranceCounseling.action?execution=e2s1>, accessed May 10, 2017.

⁶³ 34 C.F.R. §668.164(b)(3).

⁶⁴ A parent borrower may authorize an IHE to transfer PLUS loan balances to the student on whose behalf the loan is made. *FSA Handbook*, vol. 4, p. 48.

⁶⁵ An IHE generally must pay remaining Title IV aid balances to borrowers no later than 14 days after the credit balance occurs on the student's institutional account or the first day of classes of the payment period, if the credit balance occurred on or before the first day of class of the payment period. 34 C.F.R. §668.164(e). IHEs are permitted to hold credit balances on behalf of borrowers if they obtain a voluntary authorization from the borrower.

⁶⁶ New regulations recently went into effect regarding instances in which IHEs open bank accounts on behalf of a student or parent. Under the new regulations, an IHE must obtain in writing affirmative consent from the student or parent to open the account; inform the borrower of the terms and conditions associated with the account; not make any claims against the funds in the account without written permission from the borrower (except for correcting an error in transferring funds); ensure that the borrower does not incur any cost in opening the account or initially in receiving any type of debit card, stored-value card, other type of ATM card, or similar device; ensure the student has convenient access to a branch office or ATMs of the bank at which the account was opened; ensure the debit card or similar device can be convertible to cash and can be widely used; and not market or portray the account or card as a credit card or credit instrument or subsequently convert the account or card into such a device. 34 C.F.R. §668.164(c). These regulatory changes were brought about in large part due to agreements between institutions and banks that permitted student aid refunds to be deposited into new bank accounts, often linked to cobranded debit cards (e.g., debit cards with the school mascot depicted), offered by the partner bank. Critics of the practice argued the agreements exposed students to bank fees by having institutions appear to condone the opening of the new account. See, for example, Andy Thompson, "Education Dept. Proposes Reining in Deals Between Colleges and Banks," *The Chronicle of Higher Education*, May 15, 2015.

In general, IHEs must disburse the proceeds of Title IV funds, including Direct Loans, in two or more installments.⁶⁷ IHEs have some discretion⁶⁸ as to scheduling when funds may be disbursed to students, but must disburse the funds requested “as soon as administratively feasible but no later than three business days following the date the institution received” the funds from ED.⁶⁹

Cash Management

ED has in a place a number of cash management regulations that IHEs participating in Title IV programs are required to follow when requesting and managing program funds.⁷⁰ Typically, schools operate under the “advance payment method” of requesting funds. Under this method, after an IHE has submitted origination records to and a borrower’s completed MPN has been accepted by COD, the IHE requests aid funds from the G5 system,⁷¹ and if the request is accepted the school is permitted to draw down federal funds for disbursement to students. IHEs may choose to submit records verifying the Direct Loan funds have been disbursed prior to, on, or after the date of disbursement.⁷²

In instances where FSA has concerns about an IHE’s ability to meet Title IV participation requirements, FSA may require an institution to use a different form of cash management, such as the reimbursement, Heightened Cash Monitoring 1, or Heightened Cash Monitoring 2 methods. Under these methods, an institution must first disburse funds to students from institutional funds before being provided Title IV funds by ED.⁷³

Origination Fees

To help defray part of the costs associated with subsidizing Direct Loans, HEA Section 455(c) provides for origination fees that are equal to a percentage of the total loan principal amount. Borrowers are responsible for the amount of the origination fee, which is deducted from the Direct Loan borrowed (thus, the amount of the Direct Loan funds disbursed to a borrower is less

⁶⁷ For instance, an IHE that uses semesters typically disburses aid funds at the beginning of each semester. This multidisbursement requirement may be waived in certain instances for IHEs with cohort default rates for each of the 3 most recent fiscal years that were less than 15%. Additionally, the multidisbursement rule does not apply to Federal Work-Study funds. HEA §428G(a).

⁶⁸ In general, IHEs may not disburse Direct Loan program funds to students who are in the first year of an undergraduate program of study and who have not previously received a Direct Loan until 30 days after the first day of the student’s program of study. 34 C.F.R. §685.303(b)(5).

⁶⁹ 34 C.F.R. §668.62(b).

⁷⁰ See 34 C.F.R. §668.162. The cash management requirements are not applicable to the Robert C. Byrd Honors Scholarship Program, and if a state is the grantee, the Gaining Early Awareness and Readiness for Undergraduate Programs (GEAR-UP).

⁷¹ For additional information on the drawing down of Title IV funds from the G5 system, see *FSA Handbook*, vol. 4, pp. 11-12.

⁷² In general, IHEs may submit disbursement records up to 7 days prior and 15 days after the date of disbursement. U.S. Department of Education, *Common Origination and Disbursement: 2016-2017 Technical Reference*, p. VI-2-7; and *FSA Handbook*, vol. 4, p. 39.

⁷³ Under HCM1, an institution may draw down federal funds once it makes aid disbursements to students from institutional funds and provides records of the loan origination to FSA. Under the reimbursement method, an institution may be reimbursed for institutional funds used to make aid disbursements after submitting additional paperwork to FSA substantiating that students were eligible to receive the funds. Finally, HCM2 is almost identical to the reimbursement method; however, FSA may request additional documentation to substantiate an IHE’s need for Title IV funds beyond what is required under the reimbursement method. 34 C.F.R. §668.162. See also *FSA Handbook*, vol. 4, p. 13.

than the total amount borrowed). The borrower is responsible for repaying the entire amount of the loan borrowed, not just the amount disbursed. The HEA specifies that origination fees for Direct Subsidized Loans and Direct Unsubsidized Loans shall equal 1% and that the origination fee on Direct PLUS Loans shall equal 4%; however, recent budget sequestrations have required FSA to increase origination fees. For Direct Subsidized Loans and Direct Unsubsidized Loans disbursed on or after October 1, 2016, and before October 1, 2017, the origination fee is 1.069% of the amount borrowed. For Direct PLUS loans borrowed in the same time period, the origination fee is 4.276%.⁷⁴

Additional IHE Administrative Procedures

In addition to verifying student aid eligibility and awarding and disbursing aid to students, IHEs must fulfill a variety of other responsibilities related to Direct Loan program administration. These responsibilities include returning Direct Loan program funds to ED in specific instances, providing exit counseling to departing students, and reporting student enrollment information to ED.

Overpayments and Return of Title IV Aid

There are many instances in which an IHE or a borrower may be required to return Title IV aid, including Direct Loan program funds, to ED, including when an IHE has made an overpayment of funds to a student. An overpayment is the amount of Title IV aid disbursed to a student in excess of the amount for which he or she is eligible and may occur for a variety of reasons, such as when a student borrows above the annual or aggregate Direct Loan limits due to school processing errors or when a student withdraws or otherwise ceases attendance before the end of a payment period for which Direct Loan funds were disbursed. Whether an IHE or a student is required to return the Title IV funds and the amount of aid to be returned depend on a variety of circumstances, such as how much aid has been disbursed and how much aid has been “earned” in the case of a student withdrawal.⁷⁵

In general, an overpayment may be resolved in a variety of ways, depending on the circumstances. For instance, if an IHE has made the first disbursement on the Direct Loan but not the second, it may reduce or cancel any subsequent disbursements to account for the overpayment. In another instance, if an IHE has fully disbursed a Direct Loan to an ineligible student, for any of those funds disbursed directly to the student (e.g., via a check as opposed to crediting a student’s institutional account) the IHE must contact and notify the FSA-contracted loan servicer (discussed later in this report) of the outstanding loan funds so that FSA, via the servicer, may issue a letter to the student demanding repayment of the loan.⁷⁶ For those funds credited to a student’s institutional account, the IHE may be required to return some or all of the funds to ED, typically via the G5 system.

⁷⁴ U.S. Department of Education, Dear Colleague Letter GEN-16-11, “FY 2016 Sequester Required Changes to the Title IV Student Aid Programs,” May 31, 2016.

⁷⁵ Title IV funds must be returned to ED if a student withdraws from an IHE before the end of the payment period for which funds were disbursed. IHEs must follow a schedule for the return of Title IV funds based on a pro-rata calculation of the amount of Title IV aid that a student earned while enrolled, through the 60% point in each payment or enrollment period. For additional information on the return of Title IV funds, see *FSA Handbook*, vol. 4, pp. 73-98 and vol. 5.

⁷⁶ 34 C.F.R. §668.35(d). *FSA Handbook*, vol. 4, p. 78. A repayment schedule for the outstanding amount may be agreed to between the borrower and ED such that the borrower would not be responsible for repaying the entire amount at once. See also 34 C.F.R. §§668.21 & 668.22.

Exit Counseling

In addition to the entrance counseling IHEs are required to provide to first-time Direct Loan borrowers, HEA Section 485(b) requires them to provide exit counseling to all borrowers of Direct Loans, except for borrowers of Direct PLUS Loans obtained on behalf of dependent undergraduate students. The counseling must be provided to borrowers who are graduating, leaving school, or dropping below half-time enrollment.⁷⁷ The information contained in the exit counseling generally pertains to available repayment plans and debt management strategies, and borrower rights and responsibilities. As with entrance counseling, IHEs may develop their own exit counseling, so long as it fulfills HEA requirements, or they may use the ED-developed online exit counseling.⁷⁸

Student Enrollment Reporting

Throughout the award year, IHEs are required to report a variety of information to ED related to their administration of Title IV aid programs and student aid eligibility. One of the primary mechanisms that facilitates institutional reporting is the National Student Loan Data System (NSLDS).⁷⁹ Authorized by HEA Section 485B, the NSLDS is ED's central database for federal student aid records. It tracks Title IV aid through its lifecycle and includes information such as the amount, type, and status of each student loan borrowed by each individual; the IHE that originated each loan; and the servicer of each loan.⁸⁰ The NSLDS is maintained by an FSA contractor.

A key item IHEs must report to NSLDS is enrollment data for students who received Title IV aid (or on whose behalf a Direct Parent PLUS Loan is made), such as whether a student is enrolled at an IHE and is attending full- or part-time, or whether a student has withdrawn or graduated. Student enrollment information is important because it is used to determine whether a borrower is eligible for a variety of Direct Loan benefits such as in-school deferment. In addition, it is used to determine whether a borrower should be moved into repayment status, whether the borrower is eligible for a grace period, and how soon the student must begin repaying his or her loan.⁸¹

FSA Institutional Oversight

To ensure IHEs and their third-party contractors are properly administering the Title IV student aid programs, including the Direct Loan program, FSA performs a variety of oversight and enforcement tasks. First, before IHEs begin participation in the Title IV programs, FSA ensures IHEs meet numerous institutional eligibility requirements for participation.⁸² Second, FSA

⁷⁷ If the borrower drops out without notifying the IHE, the IHE must confirm that the borrower completed online exit counseling or must mail exit counseling materials to the borrower's last known address. *FSA Handbook*, vol. 2, p. 133.

⁷⁸ For additional information, see U.S. Department of Education, Office of Federal Student Aid, "Exit Counseling," <https://studentloans.gov/myDirectLoan/exitCounseling.action?execution=e2s1>, accessed May 10, 2017.

⁷⁹ Other information IHEs are required to report via NSLDS include gainful employment program records, student aid overpayment records, and transfer student monitoring records. IHEs also use NSLDS to determine some aspects of student aid eligibility (e.g., whether a borrower is in default on a Title IV loan) during the verification process. 34 C.F.R. §668.19.

⁸⁰ U.S. Department of Education, Office of Federal Student Aid, NSLDS Student Access Glossary, "Contact Type—Current Servicer," https://www.nsls.ed.gov/nsls/nsls_SA/public/SaGlossary.do#0130, accessed May 10, 2017.

⁸¹ 34 C.F.R. §685.300(b)(6); *FSA Handbook*, vol. 2, pp. 51-52.

⁸² For information on institutional eligibility requirements, see CRS Report R43159, *Institutional Eligibility for Participation in Title IV Student Financial Aid Programs*, by (name redacted).

monitors institutional (and third-party contractor) compliance with Title IV requirements by conducting program reviews and financial and compliance audits. Should FSA identify any program deficiencies,⁸³ it has the authority to impose a variety of sanctions and corrective actions on an IHE. For instance, FSA may impose a fine, place specific conditions or restrictions related to the IHE's administration of Title IV funds (e.g., require it to make specific disclosures to students or use specified types of cash management), or terminate its participation in any or all of the Title IV programs.⁸⁴

Loan Servicing

After a borrower's first Direct Loan is disbursed, it is assigned by FSA to a loan servicer, which performs a variety of Direct Loan program administrative functions as an FSA contractor.⁸⁵ This section of the report discusses key aspects of Direct Loan program administration after Direct Loans have been disbursed to borrowers.

The key parties involved in this phase of the process are the following:

- **FSA**, which solicits and awards contracts for loan servicing and monitors the effectiveness and operation of the contracted loan servicers, and
- **Loan Servicers**, which perform myriad loan servicing functions such as collecting payments on Direct Loans, processing applications for Direct Loan deferments or forbearance, and performing default prevention activities.

Loan Servicer Functions

After a Direct Loan is disbursed to a borrower, it is assigned to one of several federal student loan servicers with which FSA has contracted to perform myriad loan servicing functions. Loan servicing functions include a range of administrative tasks, including, but not limited to, processing payments, communicating with borrowers about the status of their loans, and providing information about Direct Loan benefits and features (e.g., deferment and repayment plan options). In addition, loan servicers may perform individually assigned specialized tasks specified by FSA. For instance, one federal student loan servicer is responsible for processing borrower applications for total and permanent disability loan discharges, while another is responsible for servicing all Direct Loans certified as eligible for the Public Service Loan Forgiveness (PSLF) program.⁸⁶

⁸³ For a listing of the top 10 compliance findings, see U.S. Department of Education, 2016 FSA Training Conference for Financial Aid Professionals, "Program Review Essentials and Top 10 Compliance Findings," available at <http://fsaconferences.ed.gov/conferences/library/2016/2016FSAConfSession33.ppt>.

⁸⁴ HEA §487(c)(1).

⁸⁵ In addition, Direct Loan servicers may also service federally held FFEL program loans. In 2008, the Ensuring Continued Access to Student Loans Act of 2008 (ECASLA; P.L. 110-227) granted ED the temporary authority to purchase students loans made under the FFEL program. In 2008, the Higher Education Opportunity Act (HEOA; P.L. 110-315) extended ED's temporary purchase authority through July 1, 2010. After purchasing loans made under the FFEL program, control of loan servicing was transferred to ED, and Direct Loan program loan servicers service these loans as well. Loan terms and conditions may vary between FFEL and Direct Loans. Loan servicing activities specific to FFEL program loans are beyond the scope of this report.

⁸⁶ Loan servicers are also responsible for providing support to IHEs and FSA to challenge, investigate, and appeal institutional cohort default rates.

HEA Section 456 authorizes ED to enter into contracts with third-party entities to perform loan servicing tasks; however, neither the HEA nor accompanying regulations identify the precise range of activities to be performed by contracted federal student loan servicers. Contracts between FSA and federal student loan servicers generally specify that loan servicers are expected to use “due diligence” to meet statutory and legislative requirements and other high-level requirements, but servicers are provided discretion in determining how to meet them.⁸⁷ As such, servicers are responsible for ensuring that borrower loan terms and conditions specified in statute and regulations are met,⁸⁸ but there is variability among the specific tasks servicers undertake to meet those requirements.⁸⁹

This section provides a broad overview of the common functions performed by federal student loans servicers for Direct Loans. Because servicers generally must meet statutory and regulatory program requirements but are given discretion in determining how to do so, the information presented in this section is intended to be illustrative rather than comprehensive in nature. Additionally, specific tasks performed by servicers may depend on a borrower’s individual circumstances (e.g., whether the borrower is having difficulty making monthly payments or whether the borrower is seeking loan forgiveness benefits). The section first describes the loan servicing activities typically performed by servicers for a large proportion of Direct Loan borrowers. It then provides examples of specific tasks servicers may perform in special circumstances. Finally, it describes tasks specific to servicing loans for borrowers who are delinquent on their loan payments or who have defaulted on their loans.

Common Servicing Activities

As described above, federal student loan servicers are required to ensure that Direct Loan terms and conditions are met. Although the precise method through which this is achieved may vary among servicers, in general, the following tasks are performed by all loan servicers for a large proportion of Direct Loan borrowers:

- providing required disclosures to borrowers about various Direct Loan terms and conditions before a first payment on the loan is required and periodically during repayment;⁹⁰

⁸⁷ For instance, FSA contracts with federal loan servicers include a general statement that servicers must meet all statutory and legislative requirements and specify in general terms some expected functions (e.g., loan servicers must have the ability to support borrower benefit plans). Moreover, some contracts state that FSA “does not intend to provide additional service level requirements. [FSA] does, however, expect best of business practices to be deployed.” See, for example, U.S. Department of Education, Office of Federal Student Aid, Contract with Great Lakes Educational Loan Servicer, No. ED-FSA-09-D-0012, C.1.4, Attachments A-1 through A-3; and Contract with Utah Higher Education Assistance Authority (dba CornerStone), No. ED-FSA-12-D-003, Attachments A-1 and A-2, both available at <https://studentaid.ed.gov/sa/about/data-center/business-info/contracts/loan-servicing>.

⁸⁸ Loan terms and conditions include a variety of requirements prescribed in statute and regulations including, but not limited to, interest rates, available repayment plans, deferment, forbearance, forgiveness benefits, and discharge of loan obligations in certain circumstances such as death or total and permanent disability. For additional information on Direct Loan terms and conditions, see CRS Report R40122, *Federal Student Loans Made Under the Federal Family Education Loan Program and the William D. Ford Federal Direct Loan Program: Terms and Conditions for Borrowers*, by (name redacted).

⁸⁹ In addition, federal student loan servicers must meet a variety of other requirements as specified under law and within their contracts. Other requirements include, for instance, compliance with the Federal Acquisition Regulations (FAR) applicable to acquisitions by federal agencies, provision of accounting reports to ED, and record maintenance. Loan servicer functions not relating to Direct Loan terms and conditions are beyond the scope of this report.

⁹⁰ HEA §433(b) requires certain disclosures be provided to borrowers prior to repayment, including loan servicer contact information, the estimated loan balance owed by the borrower, and a description of available repayment plans. (continued...)

- providing information to borrowers on the several repayment plan options,⁹¹ such as the Standard Repayment Plan and the various income-driven repayment plans, while the borrower is in school and during repayment;⁹²
- processing applications for enrollment in a borrower's selected repayment plan,⁹³ calculating the amount of payments owed monthly by a borrower, and sending occasional communications to borrowers regarding their selected repayment plans;
- recertifying borrower eligibility for income-driven repayment plans and recalculating monthly payments based on borrower income and family size information provided during the annual recertification process;⁹⁴
- collecting and applying loan payments to outstanding balances;
- processing requests for loan deferment or loan forbearance;
- processing applications to consolidate federal student loans into a Direct Consolidation Loan;⁹⁵
- reporting loans and loan status to consumer reporting agencies and reporting loan status to NSLDS;
- providing information to borrowers about loan cancellation, discharge, and forgiveness benefits;

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HEA §433(e) requires certain disclosures be made periodically during repayment, including the borrower's current outstanding balance, a description of any fees the borrower has been charged, and the date and amount of a payment the borrower must make to avoid additional fees. These disclosures are typically included in a borrower's monthly billing statement.

⁹¹ There is growing concern that borrowers are not well-informed about the availability of the various income-driven repayment plans. As such, FSA has recently increased its efforts to raise awareness about plan availability. However, FSA has not established specific requirements on how servicers must communicate with borrowers about the income-driven repayment plans. U.S. Government Accountability Office, *Federal Student Loans: Education Could Do More to Help Ensure Borrowers Are Aware of Repayment and Forgiveness Options*, GAO-15-663, August 2015, pp. 23-24.

⁹² For additional information the multiple income-driven repayment plans, see CRS Report R43571, *Federal Student Loan Forgiveness and Loan Repayment Programs*, coordinated by (name redacted) .

⁹³ If borrowers do not select a specific repayment plan, they are automatically enrolled in the Standard Repayment Plan.

⁹⁴ Borrowers enrolled in one of the several income-driven repayment plans (e.g., Income-Based Repayment, Pay-As-You-Earn) annually must provide their loan servicers with updated income documentation and certify their family size. This information is used by loan servicers to calculate borrowers' monthly payments under these plans.

⁹⁵ Consolidation Loans enable borrowers to combine multiple outstanding federal student loans (e.g., FFEL and Perkins program loans) into a single, new Direct Consolidation Loan. Currently, only four servicers (FedLoan Servicing, Great Lakes Educational Loan Services, Inc., Nelnet, and Navient) process applications for Consolidation Loans. However, the Consolidated Appropriations Act, 2017 (H.R. 244) requires that, no later than September 30, 2017, ED allow borrowers who are consolidating their loans to select any of the student loan servicers to service their new Direct Consolidation Loan. For additional information on the actions loan servicers complete when processing a Consolidation Loan application, see U.S. Department of Education, Office of Federal Student Aid, "New Direct Consolidation Loan Process Information – High-Level Overview of Phased Implementation Approach," November 27, 2013, Q2 and Q3, <http://ifap.ed.gov/eannouncements/112713NDCLPIHighLevelOverviewofPhasedImplementationApproach.html>.

- reporting loan interest payments to the IRS and providing loan interest payment statements to borrowers;⁹⁶ and
- providing delinquency and default prevention activities.⁹⁷

Servicing Activities for Special Circumstances

In addition to the above-listed servicing activities completed for a large proportion of Direct Loan borrowers, some loan servicing activities are carried out in special circumstances. Some of these are completed by all federal student loan servicers, while others are completed by individual loan servicers to whom the tasks have been specifically assigned. Where applicable, servicers assigned specialized tasks by FSA are noted. Servicing activities for special circumstances include the following:

- processing requests for and applying a 6% interest rate cap to eligible servicemembers' student loans pursuant to the Servicemembers Civil Relief Act;⁹⁸
- processing applications for loan forgiveness benefits, including benefits offered under the Public Service Loan Forgiveness Program;⁹⁹
- processing applications for loan discharge, including applications for total and permanent disability discharge;¹⁰⁰ and
- transferring loans to and accepting loans from other federal student loan servicers, as necessary.¹⁰¹

⁹⁶ Borrowers may be eligible to deduct a portion of the interest paid on their student loans from their federal income taxes. The student loan interest statement to borrowers is provided on IRS Form 1098-E. For additional information, see CRS Report R41967, *Higher Education Tax Benefits: Brief Overview and Budgetary Effects*, by (name redacted)

⁹⁷ Delinquency prevention activities are support services offered by servicers to help ensure borrowers do not become delinquent or default on their loans. Such activities include, for instance, permitting borrowers to select the date on which monthly loan payments will be made, offering electronic account debit for monthly payments, providing delinquency counseling (e.g., providing a series of letters and calls to borrowers who are delinquent), and providing online financial literacy materials for borrowers. U.S. Department of Education, Office of Federal Student Aid, "Loan Servicing Information—Delinquency Prevention Activities Offered by FedLoan Servicing (PHEAA), Great Lakes Educational Loan Services, Inc., Nelnet, and Sallie Mae," June 3, 2010, <http://ifap.ed.gov/eannouncements/060310LoanServicingInfoDelinqPreventAct.html>.

⁹⁸ In 2014, FSA modified its contracts with all of its loan servicers requiring them to, among other things, review their portfolios monthly for servicemembers eligible for the interest cap and apply the entitlement to those borrowers' accounts. See, for example, U.S. Department of Education, Office of Federal Student Aid, Amendment of Solicitation/Modification of Contract with Great Lakes Educational Loan Services, Inc., Amendment Modification No. 0080, p. 4, available at <https://studentaid.ed.gov/sa/about/data-center/business-info/contracts/loan-servicing>.

⁹⁹ FedLoan Servicing (PHEAA) is the sole loan servicer responsible for processing Public Service Loan Forgiveness employment certifications and applications. U.S. Department of Education, Office of Federal Student Aid, "Employment Certification for Public Service Loan Forgiveness Form," January 31, 2012, <https://ifap.ed.gov/dpletters/GEN1202.html>. Other types of loan forgiveness benefits that may be available to Direct Loan borrowers and that may be processed by all loan servicers include the Teacher Loan Forgiveness Program. For additional information on federal student loan forgiveness programs, see CRS Report R43571, *Federal Student Loan Forgiveness and Loan Repayment Programs*, coordinated by (name redacted).

¹⁰⁰ Nelnet is the sole loan servicer responsible for processing total and permanent disability discharge applications. U.S. Department of Education, Office of Federal Student Aid, "Total and Permanent Disability Discharge Information – Transition to New Servicer Planned for October 1, 2010 (Updated May 27, 2011)," August 13, 2010, <http://ifap.ed.gov/eannouncements/081310TPDTransition.html>. Other types of loan discharge that may be available to all Direct Loan borrowers and that may be processed by all loan servicers include closed school discharge and discharge due to death.

Servicing Activities During Delinquency

A Direct Loan becomes delinquent the first day after a borrower fails to make a scheduled monthly payment and continues to be delinquent until the borrower makes all payments to make his or her Direct Loan account current. Although HEA Section 435(l) provides that a Direct Loan enters default when a borrower fails to make payments on it for 270 days, in practice, a loan is not operationally treated as being in default until it has been transferred to FSA's Debt Management and Collection System (DMCS) for collection after 360 days of nonpayment.¹⁰² The activities loan servicers undertake from the time a Direct Loan first becomes delinquent to the time it is transferred to DMCS include the following:

- outreach to past-due borrowers,¹⁰³
- reporting all delinquencies of at least 90 days to consumer reporting agencies,
- performing skip-tracing activities,¹⁰⁴
- sending demand letters when a borrower is approaching default¹⁰⁵ and notices of default when a borrower defaults,¹⁰⁶ and
- entering into repayment arrangements with borrowers for loans not yet transferred to DMCS.

Loan Servicing Contracts

As described earlier, under the Direct Loan program the federal government is the owner of the loans and assumes the risk of loss through borrower default. As such, it is ultimately responsible for collecting payments on outstanding federal student loans and performing other related administrative functions, such as processing applications for deferment or loan cancellation. HEA Section 456 authorizes ED to enter into contracts with third-party entities to perform these loan

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¹⁰¹ For instance, after submitting an employment certification form to FedLoan Servicing, if it is determined that the borrower's employment qualifies for the purposes of PSLF and FedLoan Servicing does not currently service the borrower's loan, his or her loan will be transferred to FedLoan Servicing. In another instance, loans may be transferred to a new servicer if the borrower's previous servicer ceased operations as a servicing contractor for FSA. For additional information, see U.S. Department of Education, Office of Federal Student Aid, "Servicing Federally-Owned Loans: Loan Transfer Situations," June 24, 2016, available at <http://www.ifap.ed.gov/LoanServicingandCollectionInfo/attachments/ServLoanTransferSituations.pdf>.

¹⁰² U.S. Government Accountability Office, *Federal Student Loans: Education Could Improve Direct Loan Program Customer Service and Oversight*, GAO-16-523, May 2016, p. 7.

¹⁰³ Outreach includes providing information to borrowers about the consequences of delinquency and the availability of loan repayment plans and deferment and forbearance options. HEA §433(e)(3); U.S. Government Accountability Office, *Federal Student Loans: Education Could Improve Direct Loan Program Customer Service and Oversight*, GAO-16-523, May 2016, p. 12.

¹⁰⁴ In skip-tracing activities, a servicer attempts to locate a borrower whose contact information is no longer current. This could include contacting individuals identified in the borrower's loan file (e.g., relative or school attended by the borrower) and using national change of address search services.

¹⁰⁵ Demand letters inform borrowers that they are approaching default and urge them to make payments on their federal student loans. U.S. Government Accountability Office, *Federal Student Loans: Education Could Improve Direct Loan Program Customer Service and Oversight*, GAO-16-523, May 2016, p. 12.

¹⁰⁶ In addition, ED (via its loan servicers) is authorized to collect late fees equal to up to 6% for each outstanding dollar of a Direct Loan that is late per payment period missed; however, ED has never implemented these fees. 34 C.F.R. §685.202(d).

servicing tasks.¹⁰⁷ Operating under this general authority, FSA maintains contracts with nine loan servicers.¹⁰⁸ This section of the report discusses how the federal student loan servicers are compensated and the process FSA uses to allocate Direct Loans to servicers. In addition, a recent history of loan servicing is provided for context.

Recent History of Direct Loan Servicing

Immediately prior to 2009, when FFEL and Direct Loans were being made simultaneously, Direct Loan servicing was performed by a single loan servicer,¹⁰⁹ and FFEL program loan servicing functions were fulfilled by FFEL program lenders (which included IHEs, banks, and nonprofit state organizations), organizations with which FFEL program lenders had contracted, or nonprofit state-designated guaranty agencies through arrangements with the lenders and guaranty agencies participating in the FFEL program. In 2009, with the increase in volume of federally held student loans, FSA awarded contracts to four new loan servicers, known as Title IV Additional Servicers (TIVAS).¹¹⁰ In addition, in 2010 the SAFRA Act (P.L. 111-152, Title II-A) required ED to contract with eligible not-for-profit (NFP) servicers, many of which were affiliated with or part of not-for-profit state lending operations in the FFEL program.

For several years, TIVAS and NFPs operated side by side servicing Direct Loans, but they had different sources of funding and different contract provisions with FSA. Specifically, TIVAS were compensated with discretionary funds authorized under HEA Section 458 and entered into performance-based contracts with FSA.¹¹¹ Under performance-based contracts, FSA specifies desired results, and the loan servicer has discretion to decide how best to achieve them.

NFPs, on the other hand, were compensated for the administrative cost of the servicing contracts with mandatory funds until 2013. The Bipartisan Budget Act of 2013 (P.L. 113-67) then eliminated the requirement that FSA contract with NFPs and the mandatory funding for those contracts. FSA decided to retain those NFP contracts, and the NFPs are now compensated under the same HEA Section 458 discretionary funds authorization as TIVAS.

¹⁰⁷ Under the Perkins Loan program, participating institutions are responsible for servicing Perkins Loans. They often contract with third parties for Perkins Loan servicing. In other instances, Perkins Loans may be held by ED and, therefore, serviced by one of ED's contracted loan servicers.

¹⁰⁸ The nine loan servicers are CornerStone; Granite State-GSMR; Great Lakes Educational Loan Services, Inc.; HESC/Edfinancial; Missouri Higher Education Loan Authority (MOHELA); Pennsylvania Higher Education Assistance Agency/FedLoan Servicing; Navient; Nelnet; and Oklahoma Student Loan Authority Servicing (OSLA). A tenth loan servicer, the Vermont Student Assistance Corporation (VSAC), recently decided to cease operations as a federal student loan servicer. U.S. Department of Education, Office of Federal Student Aid, "Explanation of Allocation and Performance Measure Methodology," Quarter ending May 31, 2016, available at <https://studentaid.ed.gov/sa/about/data-center/business-info/contracts/loan-servicing/servicer-performance>.

¹⁰⁹ The single loan servicer was ACS Education Solutions, LLC (Xerox). Its contract with FSA expired in 2013. U.S. Department of Education, Office of Federal Student Aid, "Loan Servicing Information—Federally-Owned Loan Transfer Initiative Planned for January-August 2013," January 10, 2013, <http://ifap.ed.gov/eannouncements/011013LSIJJanAug2013TransferInitiative.html>.

¹¹⁰ The increase in federally held student loan volume can be attributed to multiple reasons. First, under the Ensuring Continued Access to Student Loans Act (P.L. 110-227), ED purchased a number of previously made FFEL program loans from lenders. Second, numerous institutions had recently switched from participation in the FFEL program to the Direct Loan program. Finally, the SAFRA Act (P.L. 111-152, Title III-A) terminated the authority to make new FFEL program loans after June 30, 2010. U.S. Department of Education, "U.S. Department of Education Expands Student Loan Serving Capacity," press release, June 17, 2009, <https://ifap.ed.gov/eannouncements/061709TitleIVStudentLoanMgmt.html>.

¹¹¹ HEA Section 142(c) requires FSA, to the extent practicable, to maximize the use of performance-based servicing contracts.

Unlike the TIVAS, until fall 2014 NFPs initially were allocated a minimum of 100,000 borrower accounts, and borrower accounts subsequently could be reallocated among the NFPs based on whether the NFPs met minimum performance requirements.¹¹² During this time, the performance requirements for NFPs were similar to, but not the same as, the performance metrics for TIVAS under their performance-based contracts. For the first several years of acting as federal student loan servicers, NFPs did not receive borrower accounts for newly disbursed Direct Loans.¹¹³ Then, in the fall of 2014, FSA implemented a single set of performance metrics and pricing to be used for both TIVAS and NFPs.¹¹⁴ For the first time, in January 2015, NFPs began to receive newly originated loans; however, from that time until March 1, 2016, TIVAS and NFPs competed for new allocations in separate pools while using the common performance metrics established by FSA in 2014. Finally, in the Consolidated Appropriations Act of 2016 (P.L. 114-113), Congress directed that new student loan borrower accounts be allocated to all loan servicers based on each servicer's performance as compared against all federal student loan servicers. Thus, as of March 1, 2016, TIVAS and NFPs now compete against each other for new Direct Loan allocations based on a single set of performance metrics and under a single pricing schedule. Hereinafter, TIVAS and NFPs will be referred to collectively as federal student loan servicers, unless otherwise noted.

Current Performance-Based Contracts

All FSA contracts with federal student loan servicers are performance-based; that is, FSA specifies desired results and the loan servicer has discretion to decide how best to achieve them. The use of performance-based contracts is intended to promote competition among federal student loan servicers to provide the best possible services to FSA and borrowers.¹¹⁵ Two ways in which FSA seeks to achieve the effective use of performance-based contracts are by providing compensation to federal student loan servicers based on borrower status and by allocating new borrower accounts to federal student loan servicers based on their ability to meet FSA-specified metrics.

Compensation

FSA seeks to achieve effective use of performance-based contracts by providing compensation to federal student loan servicers based on borrower status. For instance, federal student loan servicers are compensated at a monthly rate of \$2.85 for each borrower account serviced that is in repayment status, \$2.11 per borrower account serviced that is between 6 and 30 days delinquent on loan payments, and \$0.45 per borrower account serviced that is delinquent more than 271 days

¹¹² U.S. Department of Education, Office of Federal Student Aid, "Allocation Refills for Existing NFPs," NFP-RFP-2010, available at <https://www.fbo.gov/utills/view?id=f8d839ccc3187dc35477c016adb2c1d1>.

¹¹³ NFPs did not receive newly disbursed loans because at the time they entered Direct Loan servicing (2011 and 2013), they did not have interfaces to the system through which Direct Loan servicers receive new loans. U.S. Government Accountability Office, *Federal Student Loans: Education Could Improve Direct Loan Program Customer Service and Oversight*, GAO-16-523, May 2016, p. 10, footnote 17.

¹¹⁴ In the FY2015 Senate appropriations report, the Committee on Appropriations directed ED to implement a consistent set of metrics and pricing to be used for both TIVAS and NFPs. At that time, ED had already begun the process of doing so. U.S. Department of Education, FY2016 Department of Education Justifications of Appropriations Estimates to Congress, "Student Aid Administration," available at <http://www2.ed.gov/about/overview/budget/budget16/justifications/z-saa.pdf>.

¹¹⁵ See, for example, U.S. Department of Education, Office of Federal Student Aid, Contract with Great Lakes Educational Loan Servicer, No. ED-FSA-09-D-0012, available at <https://studentaid.ed.gov/sa/about/data-center/business-info/contracts/loan-servicing>.

(i.e., in default).¹¹⁶ In addition, loan servicers may receive “bonuses” when certain delinquency reduction benchmarks are met. For instance, a loan servicer can receive a bonus award of \$200,000 if its delinquent borrower accounts at the end of a quarter are less than 23% and \$300,000 if its delinquent borrower accounts at the end of the quarter are less than 23% and it improves upon its previous quarter’s delinquency rate.¹¹⁷ This compensation schedule is structured in a way intended to incentivize servicers to keep borrower accounts in active repayment status, as opposed to less desirable outcomes such as delinquency or default.¹¹⁸

Borrower Account Allocations

FSA also seeks to achieve effective use of performance-based contracts by allocating new borrower accounts to federal student loan servicers based on their ability to meet FSA-specified performance metrics.¹¹⁹ FSA scores each federal student loan servicer based on its performance in each of five metrics, and new borrower accounts are allocated proportionally based on the total score of all loan servicers. The five performance metrics FSA uses to determine new borrower accounts allocation, and the percentages of a servicer’s score they are worth, are

- customer service satisfaction, worth 35%;
- the percentage of borrowers in current repayment status, worth 30%;
- the percentage of borrowers who are between 91 and 270 days delinquent (i.e., have not yet defaulted) on their federal student loan payments, worth 15%;
- the percentage of borrowers between 271 and 360 days delinquent (i.e., defaulted but not yet transferred to DMCS), worth 15%; and
- FSA employee quarterly survey results, worth 5%.¹²⁰

Federal student loan servicers compete biannually for new borrower accounts based on their quarterly performance on these metrics.¹²¹ As with the compensation schedule, the allocation performance metrics are structured in a way intended to incentivize servicers to achieve more desirable outcomes (e.g., high customer satisfaction), by giving greater weight to them in the allocation scores.¹²²

¹¹⁶ For the full payment schedule, see, for example, U.S. Department of Education, Office of Federal Student Aid, Amendment of Solicitation/Modification of Contract with Great Lakes Educational Loan Services, Inc., Amendment Modification No. 0080, p. 4, <https://studentaid.ed.gov/sa/about/data-center/business-info/contracts/loan-servicing>.

¹¹⁷ Servicers may earn up to \$500,000 in bonus awards per quarter. Ibid.

¹¹⁸ U.S. Department of Education, FY2017 Department of Education Justifications of Appropriations Estimates to Congress, “Student Aid Administration,” p. Y-19, <http://www2.ed.gov/about/overview/budget/budget17/justifications/y-saa.pdf>. In addition, some student loan statuses (e.g., in-school) are considered less work intensive to service and are therefore less expensive to service. Thus, servicers receive lower compensation for borrower accounts that require less work and resources. When borrower accounts transition from these statuses to statuses requiring more work and resources (e.g., repayment), compensation increases accordingly.

¹¹⁹ Loan servicer performance metrics and account allocations are available at U.S. Department of Education, Office of Federal Student Aid, “Servicer Performance Metrics and Allocations,” <https://studentaid.ed.gov/sa/about/data-center/business-info/contracts/loan-servicing/servicer-performance>, accessed May 10, 2017.

¹²⁰ The FSA employee survey is completed by any FSA manager who has had contact with a loan servicer in a given quarter.

¹²¹ For new loans of existing borrowers, FSA attempts, to the maximum extent possible, to allocate those new loans to the servicer already holding the borrower’s other loans.

¹²² A recent GAO report found that the current loan servicer compensation and allocation structures do not fully align with ED’s goals of providing high-quality customer service and ensuring program integrity. U.S. Government Accountability Office, *Federal Student Loans: Education Could Improve Direct Loan Program Customer Service and* (continued...)

FSA Federal Student Loan Servicer Oversight

Although loan servicers generally have broad discretion in determining internal processes and procedures, FSA does provide oversight of their performance. First, as described above, FSA bases borrower account allocation and servicer compensation on servicers' ability to meet stated goals. Additionally, FSA issues guidance to loan servicers to assist them in day-to-day operations and conducts monitoring activities, such as completing annual compliance audits and assessing borrower-servicer interactions via selected phone call monitoring.¹²³

Loan Servicing and FSA Oversight Issues

Despite the numerous mechanisms for oversight of federal student loans servicers, in recent years there has been growing concern that borrowers may experience varying levels of customer service from them. For instance, GAO recently found that some borrowers may have difficulty getting ahold of their loan servicers because there are currently no minimum standards for hours of operations for loan servicer call centers.¹²⁴ In another example, loan servicers operate their own websites for borrowers to access account information and often cobrand communications with borrowers (e.g., a loan servicer may include its logo and ED's logo in its communications with borrowers), which may cause confusion for borrowers regarding which entity is servicing their loans and whom to contact.¹²⁵

To help address concerns related to inconsistent customer experiences across loan servicers, Congress directed FSA, in an explanatory statement in the Consolidated Appropriations Act of 2016 (P.L. 114-113), to publish a common policies and procedures manual for all Direct Loan servicers by March 1, 2016.¹²⁶ FSA did not meet the March 1, 2016, deadline, and it appears that it has not yet published a common policies and procedures manual.¹²⁷

In anticipation of the expiration of current loan servicers' contracts in 2019, FSA has begun the competitive process for new student loan servicer contracts. As part of the process, FSA has announced the intention to award a contract for a "single servicing solution," which would provide a singular loan servicing platform on which all ED-held loans would reside. Under this

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Oversight, GAO-16-523, May 2016.

¹²³ For a more comprehensive listing of loan servicer monitoring activities FSA conducts, see *Ibid.*, p. 18.

¹²⁴ GAO also found that FSA does not have a centralized system to track borrower complaints about loan servicers, thereby making it difficult for FSA to determine potential improvements to loan servicing. *Ibid.*, pp. 11, 18. For additional information, see also U.S. Government Accountability Office, *Federal Student Loans: Key Weaknesses Limit Education's Management of Contractors*, GAO-16-196T, November 17, 2015. However, in accordance with a Presidential Memorandum, in July 2016 FSA launched the FSA Feedback System, which is an online portal that allows federal student aid customers to "submit complaints, provide positive feedback, and report allegations of suspicious activity regarding their experience with federal student aid programs." Policy Memorandum to James Runcie, Chief Operating Officer, Federal Student Aid, from Ted Mitchell, Under Secretary, U.S. Department of Education, "Policy Direction on Federal Student Loan Servicing," July 20, 2016, as updated October 17, 2016, <https://www2.ed.gov/documents/press-releases/loan-servicing-policy-memo.pdf>, p. 6.

¹²⁵ U.S. Department of Education, Office of Federal Student Aid, "Phase 1 Solicitation: Federal Aid Servicing Solution," April 4, 2016, p. 6, available at <https://www.fbo.gov/utills/view?id=f282985294d769890f0a68fd408b2df6>.

¹²⁶ U.S. Congress, House Committee on Appropriations, *Consolidated Appropriations Act, 2016: Legislative Text and Explanatory Statement*, committee print, 114th Cong., 2nd sess., 2016, H.Prt. 98-369 (Washington: GPO, 2016), p. 1266.

¹²⁷ Specifically, ED stated it intends to develop a common set of servicing procedures but that doing so outside of the current loan servicing contract procurement process would be "prohibitively expensive." Kimberly Hefling, "Education Department misses deadline to create loan servicing manual," *Politico Pro*, April 6, 2016.

plan, multiple subcontracted customer service providers would have access to the platform and would provide customer service to borrowers. Thus, borrowers would be able to log onto a single website to get information about, make payments on, and apply for benefits for their loans.¹²⁸ Subsequently, ED officials developed policy direction that was intended to be reflected in FSA's new single servicing solution. Contractors (and subcontractors) competing for the single servicing solution contract were to be evaluated based on the extent to which they could comply with policy directions ED developed and would have been expected to meet the policy directions in the future. Policies contained in the policy directions included, for example, ensuring borrower access to "high-touch" servicing staff (i.e., knowledgeable, specially trained personnel who will evaluate borrowers' specific circumstances when providing assistance), informing borrowers of income-driven repayment plans, and providing consistent branding under ED's name, all of which address previously identified deficiencies in federal student loan servicing.¹²⁹ On April 11, 2017, the Secretary of Education withdrew the policy directions.¹³⁰ However, the solicitation for loan servicing contracts has not yet been amended to reflect the withdrawal of the policy directions; thus, the extent to which the guidance included in those policy directions may be incorporated into any future loan servicing contracts is unclear.

Default and Debt Resolution

If a borrower defaults on his or her Direct Loan, a variety of actions may be taken by FSA and its contractors to attempt to reinstate it as a loan in active repayment and recover payment on it. This section of the report discusses administrative processes undertaken if a borrower defaults on his or her Direct Loan.

The key parties involved in the process are the following:

- **FSA**, which solicits bids and awards contracts for the Debt Management and Collection System (DMCS) and for private collection agencies (PCAs). FSA also monitors the effectiveness and operation of the contracted DMCS and PCAs.
- **Debt Management and Collection Services**, which is a system operated by a contractor that stores, retrieves, and edits debtor information; generates official correspondence to debtors from FSA, PCAs, and other interested parties; and processes payments on defaulted loans.¹³¹ To support DMCS, the **Default Resolution Group (DRG)** serves as the contact center for DMCS and manages and oversees FSA's collection efforts on defaulted loans, makes the first attempt at collecting on defaulted loans, and collects payments on certain loan accounts via DMCS.

¹²⁸ Letter from Ted Mitchell, Under Secretary, U.S. Department of Education, to James Runcie, Chief Operating Officer, Federal Student Aid, July 20, 2016, as updated October 17, 2016, <https://www2.ed.gov/documents/press-releases/loan-servicing-policy-memo.pdf>.

¹²⁹ See, for example, Consumer Financial Protection Bureau, *Student Loan Servicing: Analysis of Public Input and Recommendations for Reform*, September 2015, http://files.consumerfinance.gov/f/201509_cfpb_student-loan-servicing-report.pdf.

¹³⁰ U.S. Department of Education, "Memorandum from Secretary of Education Betsy DeVos to FSA Chief Operating Officer James Runcie Regarding Student Loan Servicer Recompete," press release, April 11, 2017, <https://www.ed.gov/news/press-releases/memorandum-secretary-education-betsy-devos-fsa-chief-operating-officer-james-runcie-regarding-student-loan-servicer-recompete>.

¹³¹ U.S. Department of Education, Privacy Impact Assessment for Debt Management and Collection System (DMCS), June 30, 2014, <https://ed.gov/notices/pia/dmcs.pdf>.

- **Private Collection Agencies**, which perform tasks to recover payment on outstanding loans from borrowers who defaulted.

Direct Loan Default and Payment Collection Options

As stated earlier, although the HEA provides that a borrower defaults on a Direct Loan when he or she fails to make required payments on the loan for 270 days, in practice, a borrower is not operationally treated as being in default on his or her Direct Loan until the loan has been transferred to DMCS.¹³² Both statute and regulations specify numerous potential consequences of default for borrowers, which include demand of payment of all principal and interest due in full, as well as collection costs; reports to consumer reporting agencies; and ineligibility for additional Title IV federal student aid and certain loan benefits and privileges.¹³³

FSA has several debt collection options it may utilize to collect on defaulted Direct Loans and to potentially bring borrowers out of default. These can be classified as voluntary options (when a borrower agrees to make payments on the loan) and involuntary options (when the federal government takes action to collect payment from a borrower). **Table 2** depicts the voluntary and involuntary methods FSA may use to collect payment on defaulted loans.

Table 2. Department of Education Methods to Collect Payment on Defaulted Direct Loans

Option	Description
Voluntary Options	
Payment in full	Permits borrowers to immediately repay the full amount of principal, interest, and collections costs of their defaulted loan. ^a
Rehabilitation	Offers borrowers the opportunity to have their loan reinstated as a loan in active repayment. During a period of 10 consecutive months, a borrower must make 9 monthly payments within 20 days of the due date according to a plan agreed to by the borrower and ED (typically via PCAs). ^b Borrowers may rehabilitate their defaulted loans only once.
Consolidation	Permits borrowers to consolidate their defaulted loans into a new Direct Consolidation Loan, which goes into active repayment status. A borrower must agree to repay the new Direct Consolidation Loan under one of the income-driven repayment plans or make three consecutive, voluntary, on-time, full monthly payments on the defaulted loan before consolidation.
Compromise	Permits borrowers to pay, in full, a lump sum that is a lesser amount than the total amount owed on the loan to satisfy the loan debt in full. ^c
Involuntary Options^d	
Administrative Wage Garnishment	Allows ED to collect up to 15% of a borrower's disposable pay ^e from his or her nonfederal employer to pay the borrower's debt.
Treasury Offset Program	ED refers a borrower's account to the Department of the Treasury to offset certain benefits owed to the borrower, such as Social Security benefits or federal or state income tax refunds.

¹³² 34 C.F.R. §685.102(b).

¹³³ For instance, borrowers whose loans are defaulted lose eligibility for the income-driven repayment plans and deferment and forbearance. 34 C.F.R. §§685.204, 685.209, and 685.221.

Option	Description
Federal Salary Offset	Allows ED to collect up to 15% of a current or former federal employee's disposable pay, ^e or if the debt cannot be satisfied against current disposable pay, a specified amount from a former federal employee's federal retirement account, severance pay, lump sum annual leave payment, or final salary check to pay the borrower's debt. ^f
Litigation	ED refers a borrower's account to the Department of Justice for civil litigation against the borrower.

Source: CRS analysis of 34 C.F.R. §§685.102, 685.211; 34 C.F.R. Parts 30, 31, & 34, 34; U.S. Government Accountability Office, *Federal Student Loans: Better Oversight Could Improve Defaulted Loan Rehabilitation*, 14-256, March 2014.

- a. In rare instances, a borrower may owe other fees, such as administrative fees that were previously added to the loan balance or late payment penalties.
- b. In addition, borrowers must enter into a formal rehabilitation agreement and provide income documentation.
- c. Generally, compromise payments must be made within 90 days of entering into a compromise agreement.
- d. Involuntary payment methods do not count toward the required number of payments for loan rehabilitation.
- e. Disposable pay is defined as compensation for personal services from an employer, minus health insurance premiums and other amounts required by law to be withheld (e.g., Social Security taxes and withholding taxes).
- f. Federal salary offset is considered a subset of the Treasury Offset Program, but it is governed by separate regulations that are slightly different from TOP regulations.

Both the Default Resolution Group (DRG) and PCAs (and to a limited extent, loan servicers) may use one or more of the methods described in **Table 2** to attempt to collect defaulted Direct Loans. Statutory and regulatory provisions provide little guidance regarding the precise sequence in which these methods are to be applied. In general, the DRG and PCAs are not required to take these steps in a particular sequential order, and whether one or more of the methods is pursued depends on each individual borrower's specific circumstances.¹³⁴ Ways in which the DRG and PCAs undertake each of these functions are discussed in the following sections; however, some generalizations can be made about the processes DRG and PCAs use to collect defaulted Direct Loans:

1. Rehabilitation is the most frequently used method to collect defaulted Direct Loans and to bring a borrower out of default.¹³⁵ Loan consolidation is the second most frequently used method.
2. Litigation is the last option used when attempting to collect defaulted Direct Loans and is used in a very small number of cases.¹³⁶
3. It is possible that multiple payment collection options could be utilized simultaneously (e.g., a borrower's income could be garnished via an

¹³⁴ This description is based in part on an understanding of operational practices acquired through informal discussions with ED staff involved in administering these services. Citations to additional resources are provided when applicable.

¹³⁵ U.S. Government Accountability Office, *Federal Student Loans: Better Oversight Could Improve Defaulted Loan Rehabilitation*, 14-256, March 2014, p. 10.

¹³⁶ U.S. Department of Education, Office of Federal Student Aid, "Loan Servicing and Collection—Frequently Asked Questions," JPJ-Q2, <https://ifap.ed.gov/LoanServicingandCollectionInfo/LSCFAQ.html#JPJ-Q1>, accessed May 9, 2017.

administrative wage garnishment and they could enter into a loan rehabilitation agreement with a PCA).¹³⁷

Debt Resolution Activities

The DMCS and DRG, PCAs, and FSA all participate in debt resolution activities to attempt to bring borrowers out of default and to collect payment on defaulted Direct Loans. This section of the report describes some typical functions performed by each party.¹³⁸

Debt Management and Resolution System and the Default Resolution Group

As described previously, the DMCS is a contracted system that performs myriad debt collection and other functions on default loans. The DRG serves as the contact center for DMCS. After a defaulted loan is transferred to DMCS from a loan servicer, DMCS generates a letter advising a borrower that he or she can avoid assignment of the defaulted loan to a PCA by either entering into a voluntary repayment agreement or by providing proof that the debt is legally unenforceable.¹³⁹ If a borrower does not complete either of these actions within 60 days, the defaulted loan may be assigned to one of several contracted PCAs, which complete a variety of tasks related to attempting to bring borrowers out of default and collecting payment on defaulted loans (discussed below). In certain instances, the FSA may decide not to assign a borrower's account to a PCA, such as if the amount owed is less than \$500.¹⁴⁰ In these cases, the loan will remain in DMCS. In instances in which a PCA has been unsuccessful in collection on a defaulted loan, the PCA may be required to return the loan to DMCS for assignment to another PCA.

For those borrower accounts held by DMCS, DRG may perform many of the typical debt collection activities performed by a PCA,¹⁴¹ such as identifying accounts eligible for rehabilitation and identifying accounts eligible for administrative resolution, such as loan discharge due to death or total and permanent disability.¹⁴² In addition, the DMCS processes all payments¹⁴³ made by defaulted borrowers on their loans, regardless of whether a loan has been

¹³⁷ FSA is required to suspend administrative wage garnishment after the fifth valid loan rehabilitation payment. U.S. Department of Education, Office of Federal Student Aid, "Loan Servicing and Collection—Frequently Asked Questions," LR-Q9, <https://ifap.ed.gov/LoanServicingandCollectionInfo/LSCFAQ.html#LR-Q9>, accessed May 9, 2017.

¹³⁸ Descriptions in this section are based in part on an understanding of operational practices acquired through informal discussions with ED staff involved in administering these services as well as a review of federal statute, regulations, guidance, and contracts. Citations to these resources are provided when applicable.

¹³⁹ For example, a borrower may show that a Direct Loan was taken out in his or her name as a result of a crime of identity theft. HEA §437(c)(1).

¹⁴⁰ In addition, an account is not transferred to a PCA if the borrower enters into a repayment agreement within 60 days of receiving an initial default notification, if the borrower is active military, or if the borrower is identified as "medical improvement not expected" by the Social Security Administration for purposes of discharge due to total and permanent disability.

¹⁴¹ Although DRG performs these tasks, because DRG does not make outbound calls to borrowers, it may be necessary for the borrower to initiate contact with DRG to ensure some of these actions take place.

¹⁴² Unlike PCAs, DRG does not initiate an administrative wage garnishment (AWG). However, DRG does draft any hearing responses for all borrower-requested AWG hearings and submits those drafts to FSA for review.

¹⁴³ Payments made by borrowers may include amounts for loan principal, interest accrued, and collection costs. HEA §484A(b)(1) requires borrowers with defaulted loans to pay "reasonable collection costs" associated with those loans. Collection costs include, but are not limited to, attorney fees and court costs and costs associated with debt collection activities (e.g., commissions paid to PCAs for obtaining payment, telephone and mailing costs). Collection costs can equal up to 25% of the principal and interest repaid by a borrower. 34 C.F.R. §§30.60 and 685.202; U.S. Department of Education "Collection Costs," <https://myeddebt.ed.gov/borrower/collectionCostsNavigate>, accessed May 10, 2017. See (continued...)

assigned to a PCA. It also reports loan status to NSLDS, and reports loans and loan status to consumer reporting agencies.

Private Collection Agencies

In many instances, if a borrower becomes more than 360 days delinquent on his or her Direct Loan, the account is assigned to one of several PCAs with which FSA has contracted to perform myriad debt resolution functions.¹⁴⁴ These include determining whether a borrower account is eligible for administrative resolutions, such as loan discharge due to death or total and permanent disability; attempting to obtain voluntary payment from a borrower by, for instance, negotiating reasonable repayment schedules with a borrower for potential loan rehabilitation; and determining whether a borrower account is eligible for some involuntary payment methods, such as administrative wage garnishment.¹⁴⁵

Unlike with loan servicing, a variety of federal statutes and regulations dictate many facets of federal debt collection in general and ED debt collection, via PCAs, specifically. For instance, the Federal Claims Collections Standards set forth the standards federal agencies use in the “collection, offset, compromise, and the suspension or termination of collection activity for civil claims for money, funds, or property,”¹⁴⁶ and ED regulations contain requirements that specifically pertain to debt collections undertaken by ED.¹⁴⁷ In addition, the Fair Debt Collections Practices Act prescribes standards that debt collectors in general must follow, which are intended to eliminate abusive debt collection practices.¹⁴⁸ Finally, FSA’s contracts with PCAs provide more detail than its contracts with federal loan servicers regarding specific tasks to be performed;¹⁴⁹ however, PCAs are given some discretion to determine how to complete those tasks.¹⁵⁰

This portion of the report provides a broad overview of the common functions performed by PCAs when performing debt collection tasks. The first section describes payment collection tasks PCAs perform and the second section describes other administrative functions they perform. Because PCAs must meet numerous statutory, regulatory, and contract requirements, but are given some discretion in determining how to meet them, the information presented in this section is intended to be illustrative and not comprehensive in nature. In addition, the exact tasks and

(...continued)

also U.S. Department of Education, Office of Federal Student Aid, “Loan Servicing and Collection—Frequently Asked Questions,” CF-Q1, <https://ifap.ed.gov/LoanServicingandCollectionInfo/LSCFAQ.html#CF-Q1>, accessed May 10, 2017.

¹⁴⁴ In addition, contracted PCAs may perform debt resolution activities for federally held FFEL program loans and Perkins Loans and overpayments of Title IV student aid owed by students.

¹⁴⁵ U.S. Department of Education, Office of Federal Student Aid, Task Order No. ED-FSA-09-O-xxx, Attachment A, “Statement of Work,” July 3, 2013, available at <https://www.fbo.gov/utills/view?id=80df526c4f67b95e40da1f8ba879aef2>.

¹⁴⁶ 31 C.F.R. §900.1.

¹⁴⁷ 34 C.F.R. Parts 30, 31, and 34.

¹⁴⁸ For additional information, see CRS Report R43041, *Fair Debt Collection Practices Act (FDCPA)*, by (name red acted).

¹⁴⁹ For a full listing of statutes, regulations, and requirements that apply to FSA PCA contractors, see, for example, U.S. Department of Education, Office of Federal Student Aid, Contract with Delta Management Associates, Inc., GS-23F-0022T, available at <https://studentaid.ed.gov/sa/about/data-center/business-info/contracts/loan-servicing>.

¹⁵⁰ For instance, PCAs may develop their own collections letters and forms, but FSA contracts with PCAs specify that PCAs must receive approval of all collections forms and letters from FSA. *Ibid.*

functions performed by PCAs vary depending on the precise circumstances of each borrower account allocated to them.

Payment Collection Tasks

PCAs' primary function is to collect payment on defaulted Direct Loans, and they have a variety of options available to them to do so. The precise conditions under which any of the collection options are available to PCAs depends on each borrower's individual circumstances; however, in general, PCA debt collection tasks can be summarized in the following manner:¹⁵¹

- PCAs typically first attempt to determine whether a borrower's account is eligible for an administrative resolution. This could include determining whether a borrower is eligible for discharge of his or her loan due to death, total and permanent disability, or meeting certain loan forgiveness program requirements (e.g., Stafford Loan Forgiveness for Teachers) and determining whether a borrower's account is eligible for collection suspension due to incarceration.¹⁵²
- If these options are unavailable, typically PCAs will then attempt to contact the borrower and offer him or her voluntary options for debt resolution, including negotiating a "reasonable and affordable" payment schedule, which could include rehabilitation or consolidation.¹⁵³
- Depending on individual borrower circumstances, a PCA may also offer a compromise of loan payment¹⁵⁴ or determine whether a borrower is eligible for administrative wage garnishment.

¹⁵¹ Descriptions in this section are based in part on an understanding of operational practices acquired through informal discussions with ED staff involved in administering these services as well as a review of federal statute, regulations, guidance, and contracts. Citations to these resources are provided when applicable.

¹⁵² For instance, if a borrower will be incarcerated for less than nine months, a PCA will suspend collection activities until the borrower's anticipated parole date. U.S. Department of Education, Office of Federal Student Aid, Task Order No. ED-FSA-16-R-0009, Attachment 1, "Default Collection Services," December 11, 2015, available at <https://www.fbo.gov/utills/view?id=773d0cdbe23eb279da8dd5eb631249>. For borrowers incarcerated for more than 10 years, ED will "write off" the loan as uncollectable. U.S. Department of Education, Office of Federal Student Aid, "Loan Servicing and Collection—Frequently Asked Questions," IB-Q1, <https://ifap.ed.gov/LoanServicingandCollectionInfo/LSCFAQ.html#IB-Q1>, accessed May 10, 2017.

¹⁵³ Initially, in offering loan rehabilitation a PCA will offer a borrower a reasonable and affordable monthly payment equal to 15% of the amount by which a borrower's adjusted gross income exceeds 150% of the federal poverty guidelines, divided by 12. However, a PCA may recalculate the reasonable and affordable monthly payment based on additional information provided by the borrower. The recalculation will take into consideration a variety of factors such as the borrower's disposable income, including public assistance payments, the reasonable and necessary expenses of the borrower (e.g., food, housing, medical costs), and family size. 34 C.F.R. §685.211(f). PCAs are not required to calculate a "reasonable and affordable" payment using the 15% rule if negotiating with borrowers for a type of repayment other than rehabilitation. U.S. Department of Education, Office of Federal Student Aid, "Loan Servicing and Collection—Frequently Asked Questions," LR-Q1, <https://ifap.ed.gov/LoanServicingandCollectionInfo/LSCFAQ.html#LR-Q1>, accessed May 10, 2017.

¹⁵⁴ A compromise is an agreement between a PCA and a borrower in which the borrower agrees to pay, in full, a lump sum that is a lesser amount than the total amount owed on the loan. Generally, offers of compromise are available in limited circumstances approved by ED. PCAs may only discuss compromise "after negotiations on the borrower's ability to pay have progressed, and only under those circumstances wherein FSA has not forbidden the compromise." U.S. Department of Education, Office of Federal Student Aid, Task Order No. ED-FSA-16-R-0009, Attachment 1, "Default Collection Services," December 11, 2015, available at <https://www.fbo.gov/utills/view?id=773d0cdbe23eb279da8dd5eb631249>.

Additional Administrative Tasks

In addition to the process of negotiating with borrowers and collecting payments on defaulted federal student loans, PCAs complete the following tasks:

- locating (including skip-tracing activities) and contacting defaulted borrowers and providing information to them relating to the consequences of loan default and borrower options for addressing default;
- providing requested copies of loan records to borrowers if an offset of benefits with the TOP¹⁵⁵ is initiated;
- preparing accounts for litigation, including conducting research to determine a borrower's ability to pay and notifying a borrower of intent to litigate,¹⁵⁶ and
- returning accounts to FSA for failure to convert the account to active repayment status (at which point, the defaulted loan may be transferred to a new PCA) or to prepare an account for an administrative resolution.¹⁵⁷

Office of Federal Student Aid

In addition to managing contracts that support FSA's debt collection activities (discussed below), FSA may refer a borrower's case to the Department of Justice for litigation, or may certify borrower accounts as eligible for the U.S. Department of the Treasury's Treasury Offset Program (TOP) and refer such accounts to the TOP. The TOP is a centralized offset program that collects delinquent debts owed to federal agencies by withholding all or a portion of payments of certain federal benefits (e.g., Social Security benefits, federal income tax refunds) and remitting those payments to the relevant federal agency to satisfy an individual's debt.

Private Collection Agency Contracts

HEA Section 456 authorizes ED to enter into contracts with third-party entities to perform debt collection activities. Operating under this general authority, FSA currently maintains contracts with multiple PCAs, and contracts were most recently awarded to seven PCAs in December 2016.¹⁵⁸ This section of the report discusses compensation and how accounts are allocated to the PCAs awarded contracts in 2016, as the older PCA contracts will be phased out.

Compensation

Similar to federal student loan servicing contracts, contracts with PCAs base compensation on their overall performance. However, unlike loan servicing contracts, PCAs are paid either a

¹⁵⁵ 34 C.F.R. §§30.20-30.31 specify the offset procedures used by ED.

¹⁵⁶ U.S. Department of Education, Office of Federal Student Aid, Task Order No. ED-FSA-16-R-0009, Attachment 1, "Default Collection Services," December 11, 2015, available at <https://www.fbo.gov/utills/view?id=773d0cdbe23eb279da8dd5ebeb631249>.

¹⁵⁷ In cases of loan rehabilitation, DMCS automatically recalls the borrower's account from the PCA and transfers the loan to a loan servicer for further servicing.

¹⁵⁸ Prior to April 21, 2017, 11 of these contracts were awarded in 2014; 7 were awarded on December 9, 2016 (of which 6 recipients currently have contracts with FSA); 5 were award-term contracts (i.e., two-year extensions, issued in 2015, to contracts initially awarded in 2009), and 13 were in "in-payment retention" (that is, the contracts were awarded in 2009 and expired in 2014; however, the PCAs have retained borrower accounts that are in repayment status to avoid disruption to borrowers.). However, the precise number of current PCA contracts held by FSA is uncertain, as there is ongoing litigation about the procurement process used by ED for many of the PCA contracts.

commission based on the dollar amount of outstanding defaulted loans collected or a flat fee, depending on the collection method used.¹⁵⁹ A PCA may receive a commission equal to 15.2% of the total amount collected on a loan (including principal, interest, collection costs, and other fees) via regular payments and administrative wage garnishment and 2.75% of the final pay-off value if a defaulted loan is consolidated if a borrower established a satisfactory repayment plan prior to certification of the new Consolidation Loan. PCAs are paid a flat fee of up to \$1,710 per loan rehabilitation and \$150 for administrative resolutions (e.g., loan discharge due to death or total and permanent disability).¹⁶⁰

Borrower Account Allocations

During the first few months of the 2016 PCA contracts, FSA will transfer a fixed number of borrower accounts to each PCA. However, after the first several months of the contracts, to incentivize PCAs to perform adequately under their contracts, new accounts will be allocated to PCAs based on their ability to meet FSA-specified performance metrics. This will be known as the Contractor Performance Monitoring and Evaluation (CPME) system.¹⁶¹ Using CPME, FSA will quarterly score each PCA based on its performance using specified metrics, and new accounts will be allocated proportionally based on the total score of all PCAs.

To determine new account allocations, first FSA will calculate a Base Allocation (BA) score, using the following metrics: borrowers resolved¹⁶² and dollars collected.¹⁶³ PCAs failing to meet a minimum threshold score will be ineligible to receive new accounts in the approaching allocation.

Next, FSA will calculate a Service Quality (SQ) score for each PCA. The SQ scores will be based on each PCA's call counseling compliance¹⁶⁴ and borrower satisfaction¹⁶⁵ and will be used to

¹⁵⁹ In general, one pricing schedule was used for contracts awarded in 2009 and another was used for contracts awarded in 2014 and 2016. For a complete listing of 2016 contract PCA compensation terms, see, U.S. Department of Education, Office of Federal Student Aid, Sample Award., ED-FSA-17-D-0004, available at <https://www.fbo.gov/utills/view?id=21b20c9d9977a21fd2d3e066ac3f63d2>.

¹⁶⁰ Additionally, there are several instances in which no commission is paid to a PCA. For example, no commission is paid for any loan consolidation or rehabilitation where it is determined that the PCA did not counsel a borrower on his or her eligibility for loan discharge or where ED-determined compromise procedures were not used.

¹⁶¹ The 2009 and 2014 contracts used a different account allocation system known as Competitive Performance and Continuous Surveillance (CPCS). Under CPCS, FSA allocated borrower accounts to PCAs based on their ability to meet FSA-specified performance metrics relative to other PCAs' performance. CPCS used the following metrics to determine new account allocation: percentage of dollars collected, percentage of accounts serviced (e.g., percentage of accounts that had payments received), and percentage of accounts prepared for administrative resolutions. At FSA's discretion two additional metrics could also be used in the CPCS: percentage of PCA accounts transferred to small business subcontractors from PCAs within the unrestricted pool of the PCA competitive and service quality. A July 2014 ED Office of Inspector General (OIG) report found that FSA had not used these two additional metrics in the CPCS.¹⁶¹ In response to a 2014 ED Office of Inspector General report, FSA modified PCA contract terms to take into consideration customer complaints in its evaluation of PCA performance, which was encompassed by the service quality metric. It is unclear whether FSA has subsequently used the small business subcontracting metric in its PCA assessments. Recently, ED indicated that CPCS is no longer used for the 2014 contracts; rather, its intent is to use CPME for the 2014 contracts.

¹⁶² This metric measures the number of borrower accounts removed from a PCA's inventory during the performance period through the following means: voluntary payment in full, compromise, rehabilitation, consolidation, discharge due to death or total and permanent disability, incarceration (if the expected released date is greater than 10 years from verification), or referral to litigation.

¹⁶³ This metric measures the net amount of voluntary and administrative wage garnishment payments during the performance period.

¹⁶⁴ This will measure the percentage of FSA-monitored calls that contain no errors.

¹⁶⁵ This will measure the number of complaints received by the PCA relative to all complaints received by all PCAs.

adjust (either upward or downward) each PCA's BA score. This adjusted BA score will be known as the Adjusted Allocation Score. As with the BA score, PCAs failing to meet a minimum SQ score will be ineligible to receive new accounts in the upcoming allocation. Finally, new borrower accounts will be allocated based on each PCA's Adjusted Allocation Score as compared to all PCAs' Adjusted Allocation Scores.

FSA Private Collection Agency Oversight

In addition to FSA's use of the CPME for account allocations to PCAs, it uses a variety of other tools to oversee PCAs' debt collection activities and ensure adequate PCA performance. For instance, the 2016 PCA contracts establish Evaluation Scores that will be calculated quarterly for each PCA. These scores will represent each PCA's performance with respect to the above-described metrics as compared against all other PCAs and will be considered by FSA, along with other relevant information (e.g., compliance with federal and state laws governing collection activity, security risks, and violations) when reporting each PCA's past performance to contractor past performance databases.¹⁶⁶ In addition, FSA issues guidance to PCAs to assist them in day-to-day operations and conducts monitoring activities, such as reviewing borrower complaints against PCAs and evaluating PCAs' interactions with borrowers via phone-call monitoring.

Over the past several years, concerns have been raised that FSA may not be adequately monitoring and effectively responding to PCA performance.¹⁶⁷ For instance, GAO found that although FSA monitors PCA phone calls with borrowers, it has not consistently completed the review of such calls. Moreover, for those calls reviewed, GAO found a range of issues raising concerns about PCAs' treatment of borrowers for which FSA failed to ensure corrective action on the part of the PCAs, including providing inaccurate or misleading information about loan rehabilitation requirements and other options to borrowers. GAO concluded that by failing to effectively monitor and respond to PCA performance issues, FSA may miss opportunities to target oversight and improve program performance.¹⁶⁸ Final implementation of the 2016 PCA contracts may help to address some of these issues.

¹⁶⁶ For instance, this information would be reported to the Contractor Performance Assessment Reporting System, which is a set of web-enabled applications "used to document contractor and grantee performance information that is required by Federal Regulations." Contractor Performance Assessment Reporting System, <https://www.cpars.gov/>.

¹⁶⁷ Some concerns have also been raised that the PCA compensation structure may not incentivize PCAs to act in a borrower's best interest. See, for example, Deanne Loonin and Persis Yu, *Pounding Student Loan Borrowers: The Heavy Costs of the Government's Partnership with Debt Collection Agencies*, National Consumer Law Center, September 2014, pp. 10-18.

¹⁶⁸ Similarly, ED's OIG found that FSA did not ensure that PCAs were following federal and state debt collection laws. Federal debt collection laws include the Fair Debt Collection Practices Act, which, among other items, prohibits debt collectors from contacting consumers at unusual or inconvenient times or places and from harassing or abusing consumers while collecting or attempting to collect a debt. 15 U.S.C. §§1692c(a) and 1692d. Failure to ensure that PCAs follow such laws could result in improper borrower treatment. OIG did not speak to whether PCAs were, in fact, following federal debt collection laws; however, some consumer advocates have raised concerns that PCAs may be engaging in such behaviors. See, for example, National Consumer Law Center, *Pounding Student Loan Borrowers: The Heavy Costs of the Government's Partnership with Debt Collection Agencies*, Boston, MA, September 2014, pp. 23-25.

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