GAO

United States
General Accounting Office
Washington, D.C. 20548

Health, Education and Human Services Division

B-270915

March 11, 1996

The Honorable Nancy Landon Kassebaum
Chairman, Committee on Labor
and Human Resources
United States Senate

The Honorable William F. Goodling
Chairman, Committee on
Economic and Educational Opportunities
House of Representatives

The Federal Family Education Loan Program (FFELP), formerly known as the Guaranteed and the Stafford Student Loan programs, provides eligible students access to money for postsecondary education. The guaranty agencies are designated state or private not-for-profit entities that help administer FFELP by, for example, reimbursing lenders if borrowers fail to repay their loans. These agencies' reserves are federal funds that represent the amount by which their sources of funds have exceeded their use of funds since the beginning of agency operations. In earlier reports, we concluded that in aggregate these agencies have more reserves than they need and suggested how reserves in excess of agency needs could be recovered.[1] Subsequently, in accord with provisions of the Omnibus Budget Reconciliation Act of 1987, the Department recovered some of these agencies' reserves.

The Higher Education Amendments of 1992 set a minimum reserve standard of 1.1 percent of each guaranty agency's outstanding student loan guarantees. Subsequently, Department of Education regulations provided authority for it to recover agency reserves in excess of 2 percent of outstanding loan guarantees under certain circumstances. As of September 30, 1994, guaranty agencies administering FFELP student loans held about $1.6 billion in federal cash

[1]See, for example, Guaranteed Student Loans: Guidelines for Reducing Guaranty Agency Reserves (GAO/HRD-86-129BR, Aug. 7, 1986).

156416

reserves--more than twice the amount they held 3 years earlier. The Department of Education has proposed recovering $1.1 billion of these reserves over a 5-year period starting in fiscal year 1996. As of January 1996, however, the Department had not specified a mechanism for doing so. As agreed with your staffs, we estimated the potential savings that could result from the following two options for recovering some of these agencies' reserves and the limitations associated with these options.

-- Eliminate Department of Education administrative expense allowance (AEA) payments to guaranty agencies, regardless of the size of their current cash reserves.

-- Eliminate AEA and reduce the share of guaranty agencies' collections on defaulted loans that they retain but only for those agencies that have reserves exceeding a specified reserve standard.

POTENTIAL SAVINGS FROM ELIMINATING AEA

In fiscal years 1994 and 1995, the Department paid each guaranty agency an AEA equal to 1 percent of its new loan guarantees. Authorized under section 458 of the Higher Education Act of 1965, as amended, these are discretionary payments from the Department to help reimburse guaranty agencies for administrative expenses incurred in servicing outstanding loans in their portfolios and in guaranteeing new loans during the transition to the Federal Direct Student Loan Program.[2]

Eliminating AEA payments to guaranty agencies could save about $1 billion over 5 years, assuming that FFELP loan volume remains at fiscal year 1994 levels. (See enclosure 1 for estimates for each agency.) The size of the savings would be directly related to FFELP loan volume. For example, if no new loans were provided under the Federal Direct Student Loan Program after fiscal year 1996 and the entire volume of loans were provided under FFELP, the 5-year savings could be as high as $1.4 billion.

---

[2]Under the Federal Direct Student Loan Program, the Department provides loans to students without involvement of private lenders or guaranty agencies.

To pay for necessary administrative expenses, guaranty agencies have other sources of funds such as insurance premiums (a one-time fee of up to 1 percent of the principal amount of new loan guarantees), collections on defaulted loans, and investment earnings. In some cases, however, these sources may not be enough to cover all of an agency's necessary administrative expenses.

POTENTIAL SAVINGS FROM ELIMINATING AEA AND REDUCING COLLECTION RETENTIONS FOR AGENCIES WITH EXCESS RESERVES

After a guaranty agency pays a lender's FFELP loan default claim, the agency generally retains the loan and continues efforts to collect from the defaulted borrower. Payments that agencies subsequently collect from defaulted borrowers are shared with the Department according to a formula specified in the Higher Education Act. Agencies generally must send 73 percent of these collections to the Department, retaining 27 percent to help defray their collection costs.[3]

For agencies with excess reserves, eliminating AEA and reducing collection retention rates could save an estimated $415 million to $519 million over 5 years, depending on the minimum collection retention rate in effect. For example, eliminating AEA payments and reducing the minimum collection retention rate by 2 percentage points (from 27 to 25 percent) for all agencies whose cash reserves exceed a specified reserve standard would save an estimated $458 million. To determine whether a guaranty agency had reserves exceeding its needs, we applied a reserve standard that allows each state's guaranty agency to retain the greatest of the following:

-- $5 million,

-- 0.4 percent of the original principal amount of outstanding loan guarantees at the end of fiscal year 1994, or

-- 40 percent of claims payments made during fiscal year 1994.[4]

---

[3]In cases in which the Department does not reimburse an agency entirely for its claim payment to a lender, the agency may retain a higher portion of collections.

[4]The standard we used is similar to criteria in the Omnibus Budget Reconciliation Act of 1987, which was in effect through September 1989.

These savings could increase to about $519 million if the minimum collection retention rate were reduced by 7 percentage points to 20 percent. (See enclosures 2 and 3 for a more detailed presentation of these estimates.)

By making federal payments to guaranty agencies contingent on their having cash reserves below a certain level under this scenario, agencies would face the choice of either letting the Department recover reserves or spending them before the Department recovers them. This could give the agencies strong incentives to spend down their reserves, which would reduce our estimated savings. If spending controls were not imposed, it could encourage agencies to make unnecessary expenditures for additional staff; higher salaries or benefits; or purchases of facilities, furniture, computers, and the like.

LIMITATIONS ASSOCIATED WITH OPTIONS TO REDUCE RESERVE LEVELS

We prepared these estimates using the most recent available data from the Department's compilation of Guaranty Agency Quarterly/Annual Reports (ED Form 1130) submitted for September 30, 1993 and 1994.[5] These are reports that guaranty agencies submit to the Department concerning agency operations such as the number and amount of loans guaranteed, the status of defaulted loans, and the sources and uses of agency funds. Although these data include revisions recorded as late as September 7, 1995, Department staff indicated that the data are still incomplete but they are the best available for making these estimates.[6] We did not validate the data provided to us.

These estimates are based on certain assumptions about conditions that may vary somewhat in the future. The more significant of these assumptions follow:

---

[5]Department staff said that aggregate guaranty agency reserves were $1.74 billion on September 30, 1995; however, information on individual agencies' reserves was not readily available at the time of our analyses.

[6]In accordance with sections 428(b)(2)(C) and 428(c)(9)(B)of the Higher Education Act of 1965, as amended, the Department of Education is collecting and analyzing additional information on guaranty agencies' financial reserves. These data were not available to us at the time of our analysis.

-- The amount of each guaranty agency's new loan volume in future years will equal the amount of its fiscal year 1994 new loan guarantees (net of loan cancellations).

-- The amount of each guaranty agency's collections on defaulted loans in future years will equal the amount of its fiscal year 1994 collections.

-- The amount of each guaranty agency's cash reserves at the end of each future fiscal year will equal the amount of its reported cash reserves at the end of fiscal year 1994, except for the effect of the assumed reductions in AEA and collection retentions.

The estimates could vary by using alternative assumptions. We assessed the sensitivity of the estimates to alternative minimum guaranty agency collection retention rates. (See enclosure 2.) Our estimates would also be sensitive to changes in other assumptions. For example, FFELP loan volume could change greatly depending on the Congress' decisions on the future of the Federal Direct Student Loan Program and the degree to which the trend in each agency's loan volume differs from nationwide trends in FFELP loan volume. Similarly, the amount of each agency's collections could differ greatly from its fiscal year 1994 collections, and the level of its cash reserves could either increase or decrease substantially due to other factors such as changes in loan default rates or in operating expenses.

We made our estimates in accordance with the Federal Credit Reform Act of 1990 (P.L. 101-508), which requires that the budgetary cost of guaranteed loans be expressed as the net present value when the loans are disbursed) of the expected future federal costs (except for administrative costs, which are accounted for on a cash basis). We calculated the present value of changes in collection retention rates as of fiscal year 1996 using a discount rate of 5.8 percent--the Congressional Budget Office's forecast of the average 10-year U.S. Treasury note rate during fiscal year 1996. The estimates for savings from reductions in AEA are not subject to requirements for present value analysis; they are shown on a cash basis.

AGENCY COMMENTS AND OUR EVALUATION

On February 21, 1996, the Department of Education commented on a draft of this report (see enclosure 4). In generally commenting on the reserve issue, the Department said that, since the Student Loan Reform Act of 1993 amended the Higher Education Act, guaranty agencies' reserve funds and assets are federal property and that it is neither necessary nor appropriate for guaranty agencies to hold federal property, such as reserves, to ensure that lenders' claims will be paid because the federal government is now ultimately responsible for ensuring that these claims are paid. The Department also said that it recommends that the minimum reserve levels set by the 1992 legislation be replaced and agencies' cash needs be determined by an analysis of their working capital requirements.

In commenting more specifically on the issues in the draft report, the Department said that we did not say why the guidelines we used to set reserves are appropriate nor whether we consider these reserve levels as a replacement for the minimum levels the law specifies. We knew, as reflected in this letter, that the administration's fiscal year 1996 budget proposed recovering $1.1 billion in reserves and Department representatives said that the Department was in the process of obtaining--from the guaranty agencies--the financial data necessary to develop a mechanism for recovering that amount. We avoided interfering with the Department's efforts. Rather, in discussions with the requesters' staffs, we agreed to estimate the possible effects of a formula--similar to the criteria contained in the 1987 law--to capture some of the agencies' reserves. It was not our objective to identify an appropriate reserve level to replace the minimum level contained in law.

The Department suggested that a preferred method for offsetting payments to guaranty agencies would be to withhold reinsurance and AEA payments. These methods were used successfully to collect excess reserves in the late 1980s. We agree that these methods would work as well as those we identified to collect excess funds.

- - - - -

We conducted our review from August 1995 through January 1996 in accordance with generally accepted government auditing standards.

We are sending copies of this letter to the Secretary of Education, appropriate congressional committees, and other interested parties. Please call me at (202) 512-7014 if you or your staff have any questions regarding this letter.

Major contributors include Joseph J. Eglin, Jr., Assistant Director; Charles M. Novak; and Benjamin P. Pfeiffer.

Cornelia M. Blanchette

Cornelia M. Blanchette
Associate Director, Education
and Employment Issues

Enclosures - 4

PRELIMINARY ESTIMATES OF SAVINGS FROM ELIMINATION OF ADMINISTRATIVE EXPENSE ALLOWANCE (AEA)

Guaranty agency[a]	1-year savings	5-year savings
Alabama	$1,133,907	$5,669,537
Arizona	3,738,044	18,690,221
Arkansas	1,040,376	5,201,881
California	18,108,645	90,543,223
Colorado	2,857,522	14,287,608
Connecticut	1,464,706	7,323,531
Delaware	300,894	1,504,468
Florida	3,265,179	16,325,896
Georgia	2,967,026	14,835,130
Hawaii	305,288	1,526,438
Idaho	200,509	1,002,545
Illinois	6,256,030	31,280,149
Indiana	3,371,591	16,857,957
Iowa	3,023,704	15,118,519
Kentucky	2,192,847	10,964,237
Louisiana	1,293,575	6,467,873
Maine	1,114,440	5,572,198
Maryland	1,804,113	9,020,566
Massachusetts	10,234,563	51,172,816
Michigan	4,893,564	24,467,818
Minnesota II	7,368,749	36,843,745
Missouri	2,776,097	13,880,484
Montana	858,428	4,292,142
Nebraska II	3,451,320	17,256,601
New Hampshire	1,145,126	5,725,628
New Jersey	2,861,083	14,305,415

New Mexico	856,798	4,283,989
New York	14,906,405	74,532,026
North Carolina	1,809,554	9,047,772
North Dakota	637,455	3,187,273
Ohio	4,808,882	24,044,410
Oklahoma	2,114,418	10,572,091
Oregon	1,644,172	8,220,860
Pennsylvania	15,560,160	77,800,799
Rhode Island	1,092,473	5,462,366
South Carolina	1,722,059	8,610,293
South Dakota	938,609	4,693,047
Tennessee	2,506,604	12,533,021
Texas	9,544,160	47,720,798
USA Funds	37,879,750	189,398,751
Utah	1,629,963	8,149,816
Vermont	930,027	4,650,133
Virgin Islands	11,665	58,326
Virginia	3,717,468	18,587,342
Washington	3,600,616	18,003,078
Wisconsin	11,160,253	55,801,266
Total	$205,098,816	$1,025,494,081

Note: AEA payments are discretionary payments from the Department to help reimburse guaranty agencies' administrative expenses incurred in servicing outstanding loans in their portfolios and in guaranteeing new loans.

[a]Agencies are identified here by the state that designated them, except USA Funds, an agency that guarantees loans in several states. In several cases more than one state has designated the same agency. In other cases agencies identified separately here have merged or plan to merge. States and territories not listed are served by agencies designated by other states. Insufficient data were available for Mississippi and Puerto Rico.

SUMMARY OF PRELIMINARY ESTIMATES OF SAVINGS FROM ELIMINATING AEA AND REDUCING COLLECTION RETENTIONS FOR AGENCIES WITH EXCESS RESERVES

Dollars in millions

	First-year cash savings		Estimated cash basis savings					Estimated budgetary savings over 5 years[b]		
Minimum collection retention rate (percent)	Lower collection retention rate	Elimination of AEA for agencies with excess reserves[a]	1st Year	2nd Year	3rd Year	4th Year	5th Year	Reduction in AEA	Lower collection retention rates	Total
20	$35	$103	$139	$123	$102	$89	$59	$377	$142	$519
21	30	103	134	119	100	87	61	382	123	505
22	25	103	129	115	97	83	64	389	104	493
23	20	103	124	111	95	80	66	397	88	485
24	15	103	119	106	94	77	69	404	68	472
25	10	103	113	101	91	75	70	408	50	458
26	5	103	108	96	89	72	67	411	25	436
27	0	103	103	92	86	69	64	415	0	415

Note: Fifteen of 46 guaranty agency accounts had no excess cash reserves as of the end of fiscal year 1994 and would not be affected by these changes. Insufficient data were available for Mississippi and Puerto Rico.

[a]AEA payments are discretionary payments from the Department to help reimburse guaranty agencies' administrative expenses incurred in servicing outstanding loans in their portfolios and in guaranteeing new loans.

[b]Figures in this table assume that during each year each agency's excess reserves are first reduced by eliminating AEA payments and then by lowering the collection retention rate.

PRELIMINARY ESTIMATES OF SAVINGS FROM ELIMINATING AEA AND REDUCING COLLECTION RETENTIONS FOR AGENCIES WITH EXCESS RESERVES

	Fiscal year 1994					
Guaranty agency	Cash reserves as of 9/30/94[a]	Reserve standard[b]	Excess reserves[c]	Savings over 5 years[d]	Amount by which cash reserves were below the reserve standard[e]	AEA -- 1% of new loans[f]
Alabama	$11,468,621	$6,388,704	$5,079,917	$5,079,917	0	$1,133,907
Arizona	32,257,847	20,864,122	11,393,725	11,393,725	0	3,738,044
Arkansas	7,560,282	5,770,690	1,789,592	1,789,592	0	1,040,376
California	291,984,473	104,997,388	186,987,085	102,826,637	0	18,108,645
Colorado	34,831,363	15,488,175	19,343,188	15,988,711	0	2,857,522
Connecticut	9,678,599	13,032,233	0	0	$3,353,634	1,464,706
Delaware	4,088,381	5,000,000	0	0	911,619	300,894
Florida	52,693,795	22,534,709	30,159,086	18,703,743	0	3,265,179
Georgia	17,505,566	8,042,420	9,463,146	9,463,146	0	2,967,026
Hawaii	3,254,948	5,000,000	0	0	1,745,052	305,288
Idaho	4,997,760	5,000,000	0	0	2,240	200,509
Illinois	47,715,390	62,925,514	0	0	15,210,124	6,256,030
Indiana	18,908,733	8,968,605	9,940,128	9,940,128	0	3,371,591
Iowa	42,479,497	9,166,908	33,312,589	16,080,170	0	3,023,704
Kentucky	23,215,895	7,773,517	15,442,378	12,170,009	0	2,192,847
Louisiana	8,285,171	9,674,947	0	0	1,389,776	1,293,575

Maine	8,213,944	5,000,000	3,213,944	3,213,944	0	1,114,440
Maryland	25,689,306	9,523,598	16,165,708	10,863,186	0	1,804,113
Massachusetts	38,160,438	40,936,997	0	0	2,776,559	10,234,563
Michigan	47,712,346	18,671,902	29,040,444	28,237,016	0	4,893,564
Minnesota II	24,621,814	16,254,026	8,367,788	8,367,788	0	7,368,749
Missouri	35,350,825	11,242,643	24,108,182	14,894,399	0	2,776,097
Montana	8,509,063	5,000,000	3,509,063	3,509,063	0	858,428
Nebraska II	9,957,589	28,693,772	0	0	18,736,183	3,451,320
New Hampshire	6,202,394	5,000,000	1,202,394	1,202,394	0	1,145,126
New Jersey	23,321,915	21,401,200	1,920,715	1,920,715	0	2,861,083
New Mexico	10,152,538	5,000,000	5,152,538	4,469,078	0	856,798
New York	79,606,544	91,291,120	0	0	11,684,576	14,906,405
North Carolina	22,813,784	5,000,000	17,813,784	9,488,792	0	1,809,554
North Dakota	8,720,177	5,000,000	3,720,177	3,507,146	0	637,455
Ohio	41,209,644	24,687,047	16,522,597	16,522,597	0	4,808,882
Oklahoma	11,223,116	12,525,246	0	0	1,302,130	2,114,418
Oregon	14,604,403	7,106,971	7,497,432	7,497,432	0	1,644,172
Pennsylvania	133,633,675	47,433,885	86,199,790	86,097,713	0	15,560,160
Rhode Island	5,460,570	5,000,000	460,570	460,570	0	1,092,473
South Carolina	6,660,643	5,000,000	1,660,643	1,660,643	0	1,722,059
South Dakota	14,175,116	5,000,000	9,175,116	4,975,926	0	938,609

Tennessee	34,614,481	13,419,890	21,194,591	13,679,423	0	2,506,604
Texas	63,540,696	78,358,689	0	0	14,817,993	9,544,160
USA Funds	180,272,292	201,483,336	0	0	21,211,044	37,879,750
Utah	17,030,354	5,810,594	11,219,760	8,772,685	0	1,629,963
Vermont	4,573,845	5,000,000	0	0	426,155	930,027
Virgin Islands	297,870	5,000,000	0	0	4,702,130	11,665
Virginia	23,563,495	14,291,265	9,272,230	9,272,230	0	3,717,468
Washington	23,224,460	14,219,319	9,005,141	9,005,141	0	3,600,616
Wisconsin	50,938,121	51,871,584	0	0	933,463	11,160,253
Total	$1,584,981,779	$1,074,851,017	$609,333,441[g]	$451,053,659	$99,202,679	$205,098,816

	First year					Second year			
	Recovery of excess reserves from reductions in					Recovery of excess reserves from reductions in			
Guaranty agency	AEA	Collection retentions	Collection retention rate (percent)	Total recovery	Portion of excess reserves not recovered by year end (percent)[h]	AEA	Collection retentions	Total	Portion of excess reserves not recovered by year end (percent)
Alabama	$1,133,907	$134,448	25	$1,268,356	75	$1,133,907	$134,448	$1,268,356	50
Arizona	3,738,044	421,947	25	4,159,992	63	3,738,044	421,947	4,159,992	27
Arkansas	1,040,376	65,094	25	1,105,470	38	684,122	0	684,122	0
California	18,108,645	2,456,683	25	20,565,327	89	18,108,645	2,456,683	20,565,327	78
Colorado	2,857,522	340,221	25	3,197,742	83	2,857,522	340,221	3,197,742	67
Connecticut	0	0	27	0	-	0	0	0	-
Delaware	0	0	27	0	-	0	0	0	-
Florida	3,265,179	475,570	25	3,740,749	88	3,265,179	475,570	3,740,749	75
Georgia	2,967,026	186,454	25	3,153,480	67	2,967,026	186,454	3,153,480	33
Hawaii	0	0	27	0	-	0	0	0	-
Idaho	0	0	27	0	-	0	0	0	-
Illinois	0	0	27	0	-	0	0	0	-
Indiana	3,371,591	201,022	25	3,572,614	64	3,371,591	201,022	3,572,614	28
Iowa	3,023,704	192,330	25	3,216,034	90	3,023,704	192,330	3,216,034	81
Kentucky	2,192,847	241,154	25	2,434,002	84	2,192,847	241,154	2,434,002	68
Louisiana	0	0	27	0	-	0	0	0	-
Maine	1,114,440	100,648	25	1,215,087	62	1,114,440	100,648	1,215,087	24

Maryland	1,804,113	368,524	25	2,172,637	87	1,804,113	368,524	2,172,637	73
Massachusetts	0	0	27	0	-	0	0	0	-
Michigan	4,893,564	753,840	25	5,647,403	81	4,893,564	753,840	5,647,403	61
Minnesota II	7,368,749	170,476	25	7,539,225	10	828,563	0	828,563	0
Missouri	2,776,097	202,783	25	2,978,880	88	2,776,097	202,783	2,978,880	75
Montana	858,428	78,729	25	937,158	73	858,428	78,729	937,158	47
Nebraska II	0	0	27	0	-	0	0	0	-
New Hampshire	1,145,126	57,268	25	1,202,394	0	0	0	0	0
New Jersey	1,920,715	0	27	1,920,715	0	0	0	0	0
New Mexico	856,798	37,018	25	893,816	83	856,798	37,018	893,816	65
New York	0	0	27	0	-	0	0	0	-
North Carolina	1,809,554	88,204	25	1,897,758	89	1,809,554	88,204	1,897,758	79
North Dakota	637,455	63,975	25	701,429	81	637,455	63,975	701,429	62
Ohio	4,808,882	456,945	25	5,265,827	68	4,808,882	456,945	5,265,827	36
Oklahoma	0	0	27	0	-	0	0	0	-
Oregon	1,644,172	158,235	25	1,802,407	76	1,644,172	158,235	1,802,407	52
Pennsylvania	15,560,160	1,659,383	25	17,219,543	80	15,560,160	1,659,383	17,219,543	60
Rhode Island	460,570	0	27	460,570	0	0	0	0	0
South Carolina	1,660,643	0	27	1,660,643	0	0	0	0	0
South Dakota	938,609	56,576	25	995,185	89	938,609	56,576	995,185	78
Tennessee	2,506,604	229,280	25	2,735,885	87	2,506,604	229,280	2,735,885	74
Texas	0	0	27	0	-	0	0	0	-
USA Funds	0	0	27	0	-	0	0	0	-

ENCLOSURE 3

Utah	1,629,963	124,574	25	1,754,537	84	1,629,963	124,574	1,754,537	69
Vermont	0	0	27	0	-	0	0	0	-
Virgin Islands	0	0	27	0	-	0	0	0	-
Virginia	3,717,468	396,941	25	4,114,409	56	3,717,468	396,941	4,114,409	11
Washington	3,600,616	360,059	25	3,960,675	56	3,600,616	360,059	3,960,675	12
Wisconsin	0	0	27	0	-	0	0	0	-
Total	$103,411,567	$10,078,380		$113,489,947	81	$91,328,074	$9,785,542	$101,113,616	65

	Third year				Fourth year			
	Recovery of excess reserves from reductions in				Recovery of excess reserves from reductions in			
Guaranty agency	AEA	Collection retentions	Total	Portion of excess reserves not recovered by year end (percent)[h]	AEA	Collection retentions	Total	Portion of excess reserves not recovered by year end (percent)
Alabama	$1,133,907	$134,448	$1,268,356	25	$1,133,907	$134,448	$1,268,356	0
Arizona	3,073,742	0	3,073,742	0	0	0	0	0
Arkansas	0	0	0	0	0	0	0	0
California	18,108,645	2,456,683	20,565,327	67	18,108,645	2,456,683	20,565,327	56
Colorado	2,857,522	340,221	3,197,742	50	2,857,522	340,221	3,197,742	34
Connecticut	0	0	0	–	0	0	0	–
Delaware	0	0	0	–	0	0	0	–
Florida	3,265,179	475,570	3,740,749	63	3,265,179	475,570	3,740,749	50
Georgia	2,967,026	186,454	3,153,480	0	2,706	0	2,706	0
Hawaii	0	0	0	–	0	0	0	–
Idaho	0	0	0	–	0	0	0	–
Illinois	0	0	0	–	0	0	0	–
Indiana	2,794,901	0	2,794,901	0	0	0	0	0
Iowa	3,023,704	192,330	3,216,034	71	3,023,704	192,330	3,216,034	61
Kentucky	2,192,847	241,154	2,434,002	53	2,192,847	241,154	2,434,002	37
Louisiana	0	0	0	–	0	0	0	–
Maine	783,769	0	783,769	0	0	0	0	0
Maryland	1,804,113	368,524	2,172,637	60	1,804,113	368,524	2,172,637	46

Massachusetts	0	0	0	-	0	0	0	-
Michigan	4,893,564	753,840	5,647,403	42	4,893,564	753,840	5,647,403	22
Minnesota II	0	0	0	0	0	0	0	0
Missouri	2,776,097	202,783	2,978,880	63	2,776,097	202,783	2,978,880	51
Montana	858,428	78,729	937,158	20	697,589	0	697,589	0
Nebraska II	0	0	0	-	0	0	0	-
New Hampshire	0	0	0	0	0	0	0	0
New Jersey	0	0	0	0	0	0	0	0
New Mexico	856,798	37,018	893,816	48	856,798	37,018	893,816	31
New York	0	0	0	-	0	0	0	-
North Carolina	1,809,554	88,204	1,897,758	68	1,809,554	88,204	1,897,758	57
North Dakota	637,455	63,975	701,429	43	637,455	63,975	701,429	25
Ohio	4,808,882	456,945	5,265,827	4	725,117	0	725,117	0
Oklahoma	0	0	0	-	0	0	0	-
Oregon	1,644,172	158,235	1,802,407	28	1,644,172	158,235	1,802,407	4
Pennsylvania	15,560,160	1,659,383	17,219,543	40	15,560,160	1,659,383	17,219,543	20
Rhode Island	0	0	0	0	0	0	0	0
South Carolina	0	0	0	0	0	0	0	0
South Dakota	938,609	56,576	995,185	67	938,609	56,576	995,185	57
Tennessee	2,506,604	229,280	2,735,885	61	2,506,604	229,280	2,735,885	48
Texas	0	0	0	-	0	0	0	-
USA Funds	0	0	0	-	0	0	0	-
Utah	1,629,963	124,574	1,754,537	53	1,629,963	124,574	1,754,537	37
Vermont	0	0	0	-	0	0	0	-

ENCLOSURE 3

Virgin Islands	0	0	0	-	0	0	0	-
Virginia	1,043,412	0	1,043,412	0	0	0	0	0
Washington	1,083,791	0	1,083,791	0	0	0	0	0
Wisconsin	0	0	0	-	0	0	0	-
Total	$83,052,844	$8,304,925	$91,357,769	50	$67,064,305	$7,582,797	$74,647,101	38

ENCLOSURE 3

	Fifth year			
	Recovery of excess reserves from reductions in			
Guaranty agency	AEA	Collection retentions	Total	Portion of excess reserves not covered by year end (percent)
Alabama	$6,494	$0	$6,494	0
Arizona	0	0	0	0
Arkansas	0	0	0	0
California	18,108,645	2,456,683	20,565,327	45
Colorado	2,857,522	340,221	3,197,742	17
Connecticut	0	0	0	-
Delaware	0	0	0	-
Florida	3,265,179	475,570	3,740,749	38
Georgia	0	0	0	0
Hawaii	0	0	0	-
Idaho	0	0	0	-
Illinois	0	0	0	-
Indiana	0	0	0	0
Iowa	3,023,704	192,330	3,216,034	52
Kentucky	2,192,847	241,154	2,434,002	21

Louisiana	0	0	0	-
Maine	0	0	0	0
Maryland	1,804,113	368,524	2,172,637	33
Massachusetts	0	0	0	-
Michigan	4,893,564	753,840	5,647,403	3
Minnesota II	0	0	0	0
Missouri	2,776,097	202,783	2,978,880	38
Montana	0	0	0	0
Nebraska II	0	0	0	-
New Hampshire	0	0	0	0
New Jersey	0	0	0	0
New Mexico	856,798	37,018	893,816	13
New York	0	0	0	-
North Carolina	1,809,554	88,204	1,897,758	47
North Dakota	637,455	63,975	701,429	6
Ohio	0	0	0	0
Oklahoma	0	0	0	-
Oregon	287,805	0	287,805	0
Pennsylvania	15,560,160	1,659,383	17,219,543	0
Rhode Island	0	0	0	0
South Carolina	0	0	0	0

South Dakota	938,609	56,576	995,185	46
Tennessee	2,506,604	229,280	2,735,885	35
Texas	0	0	0	-
USA Funds	0	0	0	-
Utah	1,629,963	124,574	1,754,537	22
Vermont	0	0	0	-
Virgin Islands	0	0	0	-
Virginia	0	0	0	0
Washington	0	0	0	0
Wisconsin	0	0	0	-
Total	$63,155,113	$7,290,114	$70,445,226	26

Note: These are preliminary cash basis savings estimates from both the elimination of AEA payments and a reduction in guaranty agencies' collection retention rates to a minimum of 25 percent in cases where agencies had cash reserves in excess of a new reserve standard (see note b). AEA payments are discretionary payments from the Department to help reimburse guaranty agencies' administrative expenses incurred in servicing outstanding loans in their portfolios and in guaranteeing new loans.

[a]Amounts shown here are preliminary data. Substantial revisions to these data were pending.

[b]This cash reserve standard is the greatest of (1) $5 million, (2) 40 percent of the reported amount of all claims paid by the agency during fiscal year 1994, and (3) 0.4 percent of the original principal amount of outstanding loan guarantees as of September 30, 1994.

[c]These are the amounts by which cash reserves as of September 30, 1994, exceeded the cash reserve standard.

[d]These estimates assume that during each of 5 years AEA is eliminated and then each agency's collection retention rate is decreased to as low as 25 percent until the amount of savings equals the amount of excess reserves as of September 30, 1994. See the accompanying letter for additional assumptions. Fifteen of the 46 agencies shown had no excess cash reserves as of the end of fiscal year 1994 and would not have been affected.

[e]The total of excess reserves exceeds the difference between the cash reserves and reserve standard totals because 15 agency accounts had reserves below the reserve standard. See p. 1.

[f]These are the amounts by which the cash reserve standard in enclosure 2 exceeded cash reserves as of September 30, 1994.

[g]These are 1 percent of the amount of net loan guarantees during fiscal year 1994, excluding consolidated loans.

[h]A "0" indicates that all excess reserves would be recovered before the end of the year. A "-" indicates that the agency had no excess reserves as of the end of fiscal year 1994.

COMMENTS FROM THE DEPARTMENT OF EDUCATION

UNITED STATES DEPARTMENT OF EDUCATION

WASHINGTON, D.C. 20202-_______

February 21, 1996

Ms. Cornelia M. Blanchette
Associate Director, Education
and Employment Issues
U.S. General Accounting Office
Washington, D.C.

Dear Ms. Blanchette:

Thank you for giving the Department of Education (Department) the opportunity to review and comment on the draft report entitled: Student Loans: Guaranty Agency Reserve Levels (GAO/HEHS-96-81R).

In determining which agencies have "excess reserves" the report proposes a formula which is similar to criteria used in the recovery of reserves required by the Omnibus Budget Reconciliation Act of 1987. Specifically, the report proposes that each guaranty agency retain a reserve fund balance equal to the greater of: 1) $5 million; 2) 0.4 percent of the original principal amount of outstanding loan guarantees at the end of fiscal year 1994; or 3) 40 percent of claims payments made during fiscal year 1994. Footnote 5 in the report indicates that the standard is explained later, but the report does not ever explain why the standard used by GAO is still an appropriate method of determining how much reserves an agency should maintain. Since the recovery of reserves authorized in 1987, Congress, in 1993 added section 428 (c)(9)(A) of the Higher Education Act of 1965, as amended (HEA), to establish minimum reserve levels for guaranty agencies. The report should indicate whether GAO has considered these levels in its analysis or is recommending that they be replaced.

In fact, the Department does recommend the replacement of the minimum reserve levels set by section 428(c)(9)(A) in light of the addition of section 432 (o) to the HEA by the Student Loan Reform Act of 1993. In that addition Congress for the first time specified that the Secretary of Education would stand in the place of a guaranty agency with respect to claim payments to lenders in the event the guaranty agency becomes insolvent. Thus, the Secretary is the ultimate insurer of the loans. Also, section 422(g)(1) of the HEA was amended by the 1993 Act to state explicitly that a guaranty agency's reserve funds and assets are the property of the United States. It is neither necessary nor

Our mission is to ensure equal access to education and to promote educational excellence throughout the Nation.

COMMENTS FROM THE DEPARTMENT OF EDUCATION

Page 2

appropriate for the guaranty agencies to hold Federal property to perform what are ultimately Federal obligations, and even the bond-rating agencies no longer look to the reserve funds for this purpose. Therefore, an analysis of an agency's cash needs should focus on its working capital requirements to meet its administrative expenses and finance the negative "float" on Federal reimbursements rather than the ultimate amount of Federal liability. (The amount of funds needed to finance the "float" could be substantially reduced by making another minor revision to the statute to change the timing of the reinsurance payment). As you know, the President's Fiscal Year 1996 Budget proposed reducing the $1.6 billion cash reserves being held by guaranty agencies by $1.1 billion and a change in guaranty agency capital requirements, including establishment of a working-capital system. A reduction of that magnitude would not cause any agency to be unable to meet its insurance obligations to lenders.

The report correctly notes that the option of recovering reserves solely from those agencies with excess reserves could motivate some agencies to manipulate their finances solely to reduce their reserve fund balances. If any recovery of reserves is based on some measurement of "excess," that measurement should be based on reserve levels before proposal of the recovery.

The GAO evaluated the impact of recovering excess reserves from guaranty agencies by withholding administrative expense allowance (AEA) payments and by reducing the collection retention rate. Depending upon the time of measurement, reducing the collection retention rate as a method of recovery would create or increase the incentive for guaranty agencies to defer collections. Deferral of collections could entirely shield the collection retention from recovery by delaying collections until the end of the 5-year recovery period. The Department would prefer offsetting payments, e.g., reinsurance and AEA payments, as the mechanism for recovering those unneeded funds from the guaranty agencies. This method was used successfully to collect excess reserves and advances in the late 1980's.

In addition to these substantive comments, we wish to bring to your attention the statement on page 3 of the draft report, in discussing the potential savings from not making AEA payments to guaranty agencies, that: "For example, if no new loans were provided under the Federal Direct Student Loan Program after fiscal year 1996 and the entire volume of loans were provided under FFELP, the 5-year savings could be as high as $1.4 billion." It is, of course, a truism that a reduction of $1.4 billion in payments will save $1.4 billion. But AEA payments are the product of the AEA rate and FFELP volume. The savings cited could be equally achieved by eliminating all FDSLP volume and

Enclosure 4

COMMENTS FROM THE DEPARTMENT OF EDUCATION

Page 3

reducing the AEA rate to zero or by leaving the rate unchanged and eliminating all FFELP volume. We suggest that the sentence be deleted as potentially misleading or expanded to present the saving from eliminating all FFELP volume as well.

As a result of financial reviews of guaranty agencies conducted by my staff during the past year we have a wealth of data that could be used to develop projected cash flows of the agencies, and thus, determine the amount of working capital the guaranty agencies need to cover their financial responsibilities. If you would like to review that data, please contact Joe McCormick, Acting Director, Lender and Guarantor Oversight Staff at 401-2280.

Please let me know if we can assist you further in your study.

Sincerely,

Leo Kornfeld
Senior Advisor to the
Secretary

(104831)

Ordering Information

The first copy of each GAO report and testimony is free. Additional copies are $2 each. Orders should be sent to the following address, accompanied by a check or money order made out to the Superintendent of Documents, when necessary. VISA and MasterCard credit cards are accepted, also. Orders for 100 or more copies to be mailed to a single address are discounted 25 percent.

Orders by mail:

U.S. General Accounting Office
P.O. Box 6015
Gaithersburg, MD 20884-6015

or visit:

Room 1100
700 4th St. NW (corner of 4th and G Sts. NW)
U.S. General Accounting Office
Washington, DC

Orders may also be placed by calling (202) 512-6000
or by using fax number (301) 258-4066, or TDD (301) 413-0006.

Each day, GAO issues a list of newly available reports and testimony. To receive facsimile copies of the daily list or any list from the past 30 days, please call (202) 512-6000 using a touchtone phone. A recorded menu will provide information on how to obtain these lists.

For information on how to access GAO reports on the INTERNET, send an e-mail message with "info" in the body to:

info@www.gao.gov

PRINTED ON RECYCLED PAPER

United States
General Accounting Office
Washington, D.C. 20548-0001

Bulk Rate
Postage & Fees Paid
GAO
Permit No. G100

Official Business
Penalty for Private Use $300

Address Correction Requested