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DIRECT STUDENT LOANS

Efforts to Resolve Lenders' Problems With Consolidations Are Under Way

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The Honorable William F. Goodling
Chairman, Committee on Education
and the Workforce
House of Representatives

The Honorable Howard P. McKeon
Chairman, Subcommittee on Postsecondary
Education, Training, and Lifelong Learning
Committee on Education and the Workforce
House of Representatives

The federal government began making loans through the William D. Ford Federal Direct Loan Program (FDLP) in 1994. Under FDLP, the government provides capital for the loans, schools make the loans on behalf of the government, and a contractor services and collects loan repayments. In the Federal Family Education Loan Program (FFELP), in contrast, lenders, usually from the private sector, provide loan capital, make and service loans, and collect loan repayments. The federal government guarantees, or insures, FFELP loans against default. In academic year 1996-97, federal student loans made through FDLP constituted about $10 billion and those through FFELP about $20 billion.

The consolidation of student loans allows borrowers to combine separate loans, including those made under FDLP and those guaranteed under FFELP, into a single new loan. Consolidation loans allow borrowers to extend their repayment periods and make single monthly payments that are lower than the total of payments on their loans if made separately. Consolidation loans are available through both programs, and total consolidation loan volume for FFELP and FDLP was about $5 billion in fiscal year 1996.

The FDLP consolidation process had a number of problems that contributed to a 3-month shutdown during which new applications were not accepted. In the FDLP consolidation process, if any FFELP loans are among those being consolidated, the federal government, through its contractor, Electronic Data Systems (EDS), pays off lenders for the borrower's underlying loans and makes a new consolidation loan to the borrower. Some of the program's problems affected FFELP lenders who (1) were required to complete a loan verification certificate and send it to EDS, to verify the accuracy of borrowers' loan amounts to be consolidated, and (2) were then paid the amount due on these loans by EDS. Some lenders complained that EDS' and the Department of Education's handling of this process was prone to error and problematic for them. In response to these kinds of lender complaints, you asked us to learn more about problems that lenders have had with FDLP consolidation loans. We agreed to answer the following questions:

- What are the nature and source of problems FFELP lenders have encountered in the direct loan consolidation program?
- How have these problems affected lenders?
- What steps are Education and EDS taking to correct these problems?

As agreed with your offices, we judgmentally selected four FFELP lenders and reviewed between 8 and 13 examples from each lender that illustrated problems lenders said they were experiencing in the direct loan consolidation process—a total of 40 examples.[1] We reviewed supporting documents and discussed each example with representatives from the lenders. These officials also generally described their problems with the consolidation process. We also met with Education and EDS representatives to discuss the problems that lenders raised, the specific examples the lenders provided, the reasons for the problems, and the steps Education and EDS said they were taking to address the problems. The information regarding these examples and the problems they illustrate are specific to the lenders we contacted and cannot be generalized to all FFELP lenders, nor can we make judgments regarding the overall frequency or extent of these problems in the program as a whole. To avoid duplicating work currently being performed by Education's Office of the Inspector General, we did not conduct an evaluation of the entire FDLP consolidation program. We conducted our review from September 1997 to March 1998 in accordance with generally accepted government auditing standards. For details on our scope and methodology, see appendix I.

Results in Brief

Lenders said their problems came primarily at two stages in the consolidation process—verifying loan data EDS provided and receiving payments for the loans being consolidated. Although our sample was limited, some of the problems we found appeared to be systemic, which Education and EDS officials acknowledged. In some of the examples we reviewed, EDS sent verification requests with the wrong information or to the wrong lender, and in other examples, after the information was verified EDS sent the lender additional requests to verify the same

[1]As used in this report, "lender" refers to an entity that makes, holds, services, or collects student loans.

borrower's loan amounts. These problems occurred, in part, because borrowers provided poor information or EDS used inaccurate Education-provided data to identify lenders' addresses for loan verification requests. In other examples, EDS staff did not realize a lender had returned a verification certificate and erroneously sent the lender another request.

Regarding the payments lenders received, in some examples EDS sent inaccurate payments to lenders for loans being consolidated—at times they were much too high and at other times they were too low. Some lenders received overpayments because EDS paid for the same loan more than once. In these examples, EDS sent a lender a duplicate verification certificate (which it did not identify as a duplicate) that the lender again completed, but EDS then found the original certificate and made payments for both of them. Other examples we analyzed had more serious problems, such as several instances in which EDS charged one borrower for a second borrower's loans. However, lenders also received underpayments on occasion, which occurred because not all loans a borrower owed and wanted to consolidate were paid off. For example, one borrower was consolidating 10 loans he had with one lender. Four loans were paid for in April 1997, but the lender was underpaid for this borrower's loans until another four loans were paid in October 1997 and the last two were paid in December 1997.

In addition to the two problems lenders raised about the process, we found a flaw in the transfer of data from EDS to the FDLP servicing system.[2] We found that refunds that lenders made for overpayments were not always credited to a borrower's new consolidation loan account. This resulted in some borrowers' accounts grossly overstating the amount they owed.

Lenders' representatives said that problems associated with FDLP consolidations adversely affected their operations. Lenders said that their staffs had to repeatedly complete verification requests or call EDS to explain that a completed certificate had previously been returned. Lenders' officials also said that it took time for their staffs to resolve inaccurate payments. In general, however, lenders could not quantify their costs of resolving FDLP consolidation problems.

[2]The FDLP servicing system maintains borrowers' accounts, recording borrower payments and other adjustments to accounts. It is operated by a contractor for Education.

Both Education and EDS recognized that the consolidation process had had problems prior to the shutdown, including those cited in our examples. Officials from both Education and EDS said that they have taken new steps to improve FDLP consolidation processing. Some of the changes were made during the shutdown; others went into effect as we were conducting our study, when EDS again began accepting new applications on December 1, 1997; and others are still being implemented. For example, Education has increased its oversight and monitoring of FDLP consolidations and has made modifications to tie payments under its contract with EDS to EDS' performance. EDS has devoted more resources and made system changes to improve data quality throughout the process, it has started a pilot program for electronic loan data exchange with lenders, and it has begun a review of the first 1,000 poststartup applications with the goal of detecting remaining problems. Lenders' representatives we talked with had mixed opinions about the effectiveness of these changes and said it was too early to evaluate them.

Background

FDLP loan consolidation begins with a borrower sending EDS an application for a consolidation loan. The borrower lists each loan he or she wants to consolidate and the party holding or servicing the loan—the FDLP servicing center for FDLP loans and private lenders for FFELP loans. For FDLP loans, EDS obtains balance information from the servicing center. For FFELP loans, EDS sends a verification certificate to each lender to verify each loan and the amount owed. Lenders complete the verification information and return the certificates. Upon receiving and validating all loan verification information, EDS sends a promissory note to the borrower for signature. After the borrower signs and returns the note, EDS pays off each lender for the underlying FFELP loans and records the consolidation loan for servicing purposes. According to Education officials, EDS sends new loan transactions to the central FDLP database, managed by Computer Data Systems, Incorporated/AFSA Data Corporation (CDSI/AFSA), the Education contractor that services all direct loans. Information from the central database is then sent to the FDLP servicing system, also managed by CDSI/AFSA, for loan servicing and collection.

FDLP consolidations were first made available in March 1995 when CDSI/AFSA operated the consolidation program along with its other direct loan servicing responsibilities. Education subsequently awarded a contract to EDS to take over FDLP loan origination operations, including consolidation processing. EDS began operating the consolidation program and processing FDLP consolidation loans in September 1996. EDS' responsibilities included obtaining verification certificate information, generating promissory notes, ensuring that the promissory notes were returned, and making payments to lenders. But beginning shortly after September 1996, a backlog of unprocessed consolidation loan applications developed and grew steadily. In August 1997, with the backlog having reached about 84,000 unprocessed applications, more than half of all applications that EDS had received, Education closed down the FDLP consolidation program to new applications until December 1, 1997. EDS and Education took steps during the shutdown to resolve the backlog of applications.[3] By mid-January 1998, about 3,800 applications from the original backlog remained unresolved, and according to Education officials, only 15 remained unresolved in late March 1998.

Faulty EDS Processes Contributed to Loan Verification Problems and Inaccurate Payments; Direct Loan Servicing Information Also Flawed

Lenders' representatives said that the primary problems they had with FDLP consolidations were (1) loan verification certificates EDS them sent that contained errors and (2) inaccurate payments EDS sent to pay off loans. EDS acknowledged the systemic nature of these problems and generally attributed them to inaccurate data or inefficiencies in its processes. For example, because EDS staff relied on inaccurate data sources for loan information, EDS sometimes sent verification certificates to lenders with the wrong information. In addition, glitches in EDS' editing processes resulted in duplicate certificates being sent to lenders after original certificates had been completed and returned to EDS. With regard to payments, certain EDS errors, such as data entry mistakes or problems with multiple certificates, resulted in payments to lenders for loan amounts that were much too high and, at times, that double-paid a borrower's loans. Similar errors also caused payments to lenders that were too low, leaving a borrower with a remaining balance with the lender when the borrower's account should have been closed. While lenders focused on verification and payment problems, during the course of our work we discovered an additional system flaw: Certain differences between EDS' and the FDLP servicing center's systems, such as differing edit checks, meant that some corrections to borrowers' accounts were not recorded in the FDLP servicing system in a timely manner. Borrowers were thus left with incorrect loan balance information so long as the corrections were not posted, sometimes for many months.

[3]An application that was part of the backlog could be resolved in one of two ways: The loan consolidation could be completed, or the application could be deactivated. An application was deactivated after a specified period of time if EDS did not receive certain necessary information despite several requests or if a promissory note was sent out but not returned.

EDS Errors Caused Lenders Problems in Verifying Loan Data

The process EDS used to verify the loan amounts that borrowers wanted to consolidate was prone to error. It was designed so that lenders would verify information that EDS had in its system to determine balances that would be paid to lenders upon the consolidation of the loans. Because the process relied on faulty data sources and did not contain effective controls, lenders sometimes received a certificate with one of three problems: it contained incorrect information, it was sent to the wrong address, or it was sent after a certificate had already been sent and returned.

First, lenders sometimes received certificates containing incorrect information. EDS generally sent certificates to lenders that contained a lender's name and address; the borrower's name, address, and social security number (SSN); and the type of loans to be consolidated so that lenders could identify the loans to be certified. However, lenders' representatives told us that they received certificates containing various types of mistakes, such as a wrong name or address for a lender or names or SSNs of borrowers whose loans the lender did not own. Lenders were sometimes required to research borrowers' accounts to determine, if a certificate did not match, whether it was for the wrong loan type (such as a subsidized loan inaccurately identified as an unsubsidized loan) or for a borrower whose loan was with a different lender.

Second, lenders said verification certificates were sometimes sent to a wrong address. For example, one lender with several servicing centers around the country received certificates at one center for borrowers' loans serviced by a different center. Another lender received certificates addressed to its corporate headquarters, to which borrowers' correspondence—servicing information or payments—is not normally addressed.

EDS officials said both these problems were in part the result of its system's reliance on faulty data sources to obtain loan and lender information. EDS relied heavily on information a borrower provided on his or her application regarding lender name and address and loan type, and EDS staff did not attempt to verify this information before contacting the lender. However, borrowers did not always provide complete loan information on their applications or may have provided wrong information, such as the wrong lender's name. In addition, EDS staff relied on a computerized file of FFELP lender names and addresses, compiled and provided by Education, and EDS staff matched lenders' names and addresses provided by a borrower on his or her application to those in the file. EDS did not attempt to verify the accuracy of the information prior to sending a certificate to the lender. However, some lenders were listed with several addresses or with a wrong address, and some had names similar to those of guaranty agencies, which were also in the file but whose names were not well distinguished.

The third problem lenders mentioned was that they sometimes received more than one certificate for a particular borrower. EDS officials acknowledged that its system would sometimes sent multiple copies of the same verification certificate to a lender, even if the lender had already provided the requested information to EDS. The officials said this occurred in part because of a glitch in one of EDS' edit processes. As lenders returned completed verification certificates, EDS scanned them into a computer imaging system and, if certificates passed an edit check, generally sent them for entry into the data system. However, if a certificate being scanned had incorrect or missing data, it was set aside for manual editing. After a certain period of time elapsed without data from a certificate being entered into the data system, the system automatically generated a new certificate to be sent to the lender. Furthermore, when borrowers or lenders called EDS to inquire about the status of a loan's verification certificate, EDS customer service representatives, who had access to both data and imaging systems, would sometimes check only the data system, not the imaging system. If they noted that data were missing in the data system, they would assume the verification certificate had not been returned. EDS would then send lenders another certificate.[4]

EDS' failure to enter data from completed verification certificates also resulted in its sending letters to borrowers and lenders, inaccurately stating that the lender had not returned a certificate. EDS' system automatically generated a standardized letter if no data were entered into a borrower's file 60 days after a certificate was sent to a lender. This letter, sent to the borrower with a copy sent to the lender, said that the consolidation was delayed because the lender had not provided requested information. Lenders said they believed they were being blamed for loan consolidations being delayed when, in reality, they had returned the verification certificate.

[4]This problem was intensified during EDS' efforts to reduce the application backlog in the fall of 1997. EDS staff often sent certificates to lenders for any unresolved applications, often handwritten and via fax. In their effort to get these out quickly, EDS staff often did not check the imaging system to see if certificates had already been returned.

Verification Certificate Processing Errors and Other Mistakes Led to Inaccurate Payments to Lenders

EDS' system to pay lenders for the loans that borrowers wanted to consolidate did not always result in accurate payments. Lenders sometimes received large overpayments while at other times they received underpayments. These payment inaccuracies resulted from errors in processing verification certificates and data entry errors. In addition, in some cases a borrower's loans were charged to a second borrower's account.

EDS' system is designed to slightly overpay each loan to ensure that the borrower's original account was paid in full and closed. Lenders expect such overpayments, which enable them to close borrowers' accounts while they reconcile final payments with EDS. Large or unjustified overpayments, however, were sometimes made to lenders for a variety of reasons:

- EDS officials attributed one cause of overpayments to the multiple verification certificates that EDS erroneously sent to lenders and that lenders returned. EDS' system paid lenders on the basis of certificates that were returned. At times, therefore, EDS would receive a certificate, make a payment to a lender to pay off a borrower's loan account, and then subsequently discover a second completed certificate. EDS would then make an additional payment to the lender. For example, one lender's official said that, after completing two certificates, the lender received two checks for a borrower to pay off her loan. The two checks were issued on the same day, but they were for slightly different amounts—$58,354.46 and $58,349.02. The lender should have received only one of the checks. Another lender was asked twice to return a certificate to EDS for a borrower with two loans, one for about $3,700 and the other for about $2,000. When EDS sent promissory notes to the borrower, one note included about $8,000—counting the $2,000 loan twice and the $3,700 loan once—and a second note included the $3,700 loan again. EDS double-paid the borrower's account, sending two payment checks for each loan, totaling about $12,000, or about $6,000 in overpayment.
- Data entry errors that were not detected by EDS' systems also led to overpayments. In one example, EDS entered a $16,715.09 loan into the data system as $167,115.09. EDS did not discover or correct this error before sending the lender a check, causing an overpayment of more than $100,000. In another example, a lender certified a loan as $10,953.91, but EDS erroneously entered it as $19,953.91. EDS overpaid the lender by about $10,000.
- Other EDS processing errors went undetected by its systems and contributed to overpayments. In one example, a borrower wanted to

consolidate three subsidized Stafford loans totaling $17,000.[5] The verification certificate the lender returned to EDS showed the borrower's graduation date of May 1997. Because they were subsidized loans, the lender filled in "zero" for interest due on each loan, with a note saying "info good thru 11/30/97," the end of the borrower's grace period. However, EDS' system did not recognize that the loan was not subject to interest accrual for the 6-month grace period. EDS erroneously added interest to the payments, which it made in October 1997, resulting in overpayments. Education and EDS representatives said that accrued interest should not have been added to the loan payment.

In all overpayment cases we analyzed, borrowers signed promissory notes for amounts that exceeded what they owed, which means that borrowers might have been liable for repaying the inaccurate amount on the promissory notes. EDS representatives said that, as with lender information derived from borrowers' applications, its processes and systems rely on borrowers' knowledge of their loan amounts to prevent overpayments. They said they now realize that borrowers often believe that promissory notes they receive must be correct, perhaps believing—if they received multiple notes—that the first one they returned needed to be amended. In the cases we analyzed, Education and EDS systems did not identify the overpayment—they were detected only when the lender contacted EDS, while trying to reconcile a borrower's account, or when we brought it to EDS' attention.

Underpayments to lenders were also a problem. Most of the underpayments that we analyzed resulted from data that lenders provided to EDS not being entered into EDS' data system, while others resulted from a control EDS put in place to try to reduce duplicate payments or other system problems:

- In several examples, EDS did not enter data into its system for one of a borrower's loans when a lender certified a number of loans. EDS did not pay the lender for the omitted loan, so the borrower's account with the lender was not closed out because a loan remained unpaid. In some cases, these underpayments resulted from EDS sending lenders inaccurate or incomplete verification certificates—for example, the certificate failed to list all a borrower's loans or loan types.
- Some underpayments resulted from an overly sensitive edit check that EDS put into place to reduce the likelihood of a duplicate payment. The edit

[5]For subsidized Stafford loans, whether made through FDLP or FFELP, interest does not accrue until after the expiration of a 6-month grace period that starts when the borrower leaves school.

would not allow a borrower to have two loans in the data system with the same "first disbursement date." EDS mistakenly assumed that if the borrower had two loans disbursed on the same date, they were actually the same loan and one of the loans had been incorrectly entered in its system. However, this is an extreme assumption, because a borrower can have two different loans disbursed on the same date. For example, a student might receive a subsidized and an unsubsidized Stafford loan on the same date, such as the start of a school year. We identified several instances in which this edit led to EDS' system underpaying lenders because at least one loan a borrower applied to consolidate was not paid off.

- Another way EDS' system caused underpayments was the misidentification of loans in default at the time of consolidation. FDLP allows defaulted loans to be consolidated under certain circumstances, and the costs previously incurred to collect the defaulted loan are to be added to the borrower's amount to be consolidated.[6] Certain data fields in EDS' data system should have helped ensure that EDS could identify such loans, but EDS' records did not always contain consistent information in these fields. For one of the examples we analyzed, the data system showed that a borrower's loan was not in default, but the borrower was assigned collection costs, a system inconsistency. In this case, the loan actually was in default, but the system did not identify the inconsistency in the data. Because EDS' data system relied on the information in the "loan default" field, it did not include collection costs. Had the system also checked the field showing whether any collection costs were due, it would have seen that the account had collection costs, the consolidation loan would have included them, and the guaranty agency would have been reimbursed for them.

Perhaps the most serious examples of incorrect payment problems were those in which two borrowers' accounts were not kept separate. In these instances, during EDS' process of entering loan data into one borrower's account, EDS staff erroneously entered loan data pertaining to another borrower. The first borrower's account then included a loan with the first borrower's SSN in some places and a second borrower's SSN in others. The first borrower's account reflected the charges for these loans, in addition to his or her own.

For example, one borrower tried to consolidate loans totaling less than $100,000 but eventually accumulated a $190,000 balance in the data system because, among other errors, his account was charged for a second

[6]Guaranty agencies are entitled to receive a percentage of loan principal and interest on defaulted loans, capped at 18.5 percent, to cover their collection efforts. These costs, in addition to any late payment fees, are added to the balance being consolidated.

borrower's loans. EDS overpaid the lender by more than $90,000 on this borrower's account, and about $47,000 of this excess was for loans that belonged to the second borrower. When the lender received the payment checks, it saw the second borrower's SSN on some of the checks, saw that the second borrower's account had already been paid in full, and returned the checks to EDS. In another example of this type, EDS sent three checks to a lender for a borrower with two loans. The third loan had a different nine-digit account number that was actually the SSN of a different borrower. In all, we found four instances of this type of mistake.

FDLP Servicing System Did Not Always Reflect Adjustments to Borrowers' Accounts

Education's oversight of the data transfer process between EDS and the FDLP servicing center failed to ensure that adjustments to borrowers' accounts were credited in a timely manner. EDS' system sent loan consolidation transactions, including new loans and subsequent adjustments, to the central FDLP database for entry into the FDLP servicing system. Such adjustments included credits for refunds made by lenders on behalf of borrowers.[7] According to Education officials, consolidation data were not always smoothly transmitted between EDS' system, the central database, and the FDLP servicing system—some transactions were rejected when being moved from one system to the next, and these transactions were sent to a "suspense" file. This caused an accumulation of loan accounts showing incorrect balances until the adjustments could be properly posted. In some of the examples we reviewed, the adjustments had yet to be made.

In particular, we found that some overpayments that lenders returned to EDS were not credited to borrowers' servicing accounts. One borrower, discussed earlier, signed promissory notes totaling about $190,000, although he actually owed only about $90,000. One of his lenders received overpayments totaling over $90,000 and sent refunds of this amount to EDS in May and September 1997. As of February 1998, however, the FDLP servicing system continued to show that the borrower owed $190,000. Education officials, in attempting to explain why the borrower's account was not properly updated, said that when the borrower's account is eventually corrected, an adjustment would be made retroactive to the date of the overpayment, so that the borrower would not be liable for any

[7]For example, say a borrower owed $10,000 but was sent an FDLP consolidation promissory note for $15,000 because one loan was double-counted. If the borrower signed and returned the note, that borrower's account in the FDLP servicing system would be $15,000, and EDS would pay the lender $15,000 for the underlying loans. When the lender refunded the $5,000 overpayment to EDS, EDS would send a $5,000 refund transaction to the FDLP servicing system. After this transaction was fully processed, the account balance would reflect the $10,000 the borrower actually owed.

interest that accumulated since then. While this was the largest erroneous dollar amount we found, it was not an isolated incident. For the borrower described earlier whose $58,000 loan EDS had paid twice, FDLP servicing system records continued to show the additional $58,000 as part of her loan balance in February 1998, although EDS received the lender's refund in May 1997.[8] In all, we found 11 examples of borrowers whose refunds had not been properly credited when we completed our audit work. (For details on these and other examples we analyzed, see app. II).

Lenders Report Greater-Than-Expected Processing Time and Dissatisfied Customers, but Costs Are Difficult to Quantify

The lenders we spoke with agreed that FDLP loan consolidation problems have created difficulties for them. These difficulties included having reduced productivity, having to redeploy or hire new staff, and having their relationships with borrowers damaged. However, while lenders provided several examples of additional costs these difficulties brought, they generally could not assign a dollar value to them.

Lenders' representatives expressed concern that one EDS requirement—that verification certificates must be filled in manually rather than being electronically generated in the lender's own format—has reduced their staffs' productivity. For example, representatives from one lender said that its staff could electronically generate (that is, electronically complete borrower verifications) about 116 certificates per hour. However, this lender's staff could manually complete only 12 certificates per hour. Representatives from another lender indicated that electronically generating loan information for certificates received from EDS takes only 2 hours, but the manual copying of loan information onto the certificates can take a staff person an additional half a day to complete.

Lenders also said that they have had to redeploy or hire personnel to handle problems that have resulted from the FDLP loan consolidation process. One lender's representative said that it has shifted staff to deal with inaccurate loan payment problems and that other areas in his unit have been left understaffed. Lack of staff in these other areas resulted in delays in lenders' posting payment checks and, therefore, delays in updating borrowers' accounts to show that their loans have been paid off. Another lender's representative said that the time needed to handle

[8]In most examples we analyzed in which the borrower had not been credited for refunds, we verified that EDS received the refund but could not determine whether the refund transaction had reached the FDLP servicing system. However, in one case we determined that information reached the servicing system but had not been properly recorded. In this example, 15 refund checks were sent but 2 of them were not processed correctly, and the servicing system showed the borrower as owing $19,000 more than he should.

duplicate verification certificates, return overpayments, or make additional payment requests has resulted in extra work for the staff, although it is hard to quantify its amount.

The effect that delayed consolidations had on lenders' relationships with their borrowers was of particular concern to lenders. One lender's representative expressed concern that borrowers' mistrust of lenders increased because some borrowers' loans were not being consolidated promptly. EDS sends a letter to each borrower after sending payments to lenders, telling the borrower that his or her new consolidated loan account is active and that all underlying loans have been paid off. However, according to the representative, if a lender receives inaccurate payments for any of the borrower's loans, it can take time to resolve the difference with EDS. The representative expressed concern that borrowers assume or believe that lenders are holding up their loan consolidation, thereby increasing distrust of the lenders. Another lender's representative said that her customer service staff has received calls from borrowers asking why they are receiving late payment notices from the lender after they have been notified that their loans had been consolidated.

All four lenders we talked with agreed that their problems with the FDLP loan consolidation process had affected their operations. However, none of the lenders' representatives were able to assign a dollar cost to their experiences.

Education and EDS Are Making Changes to Improve the Consolidation Process

Since the shutdown of the FDLP loan consolidation program between August 27 and December 1, 1997, both Education and EDS have taken steps to improve the process and reduce the problems that contributed to the buildup of the backlog. For Education, these steps include a more coordinated internal approach to overseeing the program, changes to the contract with EDS that emphasize performance measures, and closer monitoring of the consolidation process and the transfer of data to the FDLP servicing system. EDS has taken new quality control steps in the consolidation process aimed at getting more accurate loan information in a timely manner. In addition, EDS has made changes to its automated system and has incorporated greater use of electronic data in some of its processes. EDS has begun evaluating these changes, but the final results are not yet available.

Education's Changes Focus on Management and Monitoring

According to Education officials, several changes since the shutdown of the loan consolidation program in August 1997 will lead to improved performance. First, Education has established a team focused on managing FDLP consolidations, made up of staff on full-time detail from four units within the Department responsible for different aspects of the consolidation process—contract management, systems management, program management, and financial management. Before establishing this team, Education had not designated a person or team to manage FDLP consolidations. Instead, it used staff from a number of units to manage the program, but these staff had responsibilities in their own areas and were able to devote only part of their time to consolidations. Furthermore, little coordination existed internally between the various units. Education hopes this new team, which began meeting in mid-January 1998, will provide much more coordinated oversight within the Department. Among other tasks, the consolidation team is working directly with lenders to try to resolve consolidation problems. For example, according to Education officials, the team is working with certain lenders to create an electronic certification process.

Second, EDS' contract with Education was amended to tie contract payments to EDS to performance under the contract. According to Education staff, under the original contract between Education and EDS, the terms surrounding consolidation responsibilities, systems, and processes lacked specificity. The modification signed on January 27, 1998, includes provisions for increased payments to EDS but at a level that depends on its timeliness in processing consolidation applications. For example, EDS will be paid a per-unit price for each application EDS completes within a target number of days, and as an incentive to complete applications quickly, it will be paid a bonus for each day in advance of the target that consolidations are achieved. In addition, the contract provides an additional incentive payment for each consecutive 3-month period in which EDS meets a set of performance criteria that is to be developed by the company. The modification also includes a financial penalty for performance shortcomings, such as not meeting performance measures in a consecutive 3-month period.

Third, Education is monitoring the consolidation process more closely now than before the shutdown. Education officials said they meet with EDS staff early mornings three times a week to discuss problems. In addition, Education staff receive much more, and more detailed, information on performance statistics than EDS made available during the first year under the contract. For example, EDS sends Education staff daily summary statistics detailing how many applications are at each stage of the consolidation process. One summary report shows, for example, that on January 19, 1998, EDS had received more than 13,000 applications since reopening the consolidation process on December 1, 1997. About 1,430 applications had been deactivated or rejected or were waiting to be processed. Of the remaining applications, about 7,700 were awaiting lenders' return of verification certificates and another 1,260 were awaiting promissory notes returned from borrowers or review by EDS staff. About 2,750 applications, or about 20 percent of all applications received since the December 1 reopening, had been completed. By March 30, 1998, about 17,000 of 41,000 applications received, or 41 percent, had been completely processed, according to Education officials.

Finally, Education is working to ensure that transactions flow smoothly between EDS and CDSI/AFSA electronic systems. Education officials said that EDS and CDSI/AFSA have been working since October 1997 to reduce a large number of transactions that had not been successfully transferred from EDS to CDSI/AFSA. Education officials also said that changes are under way that are intended to improve the transfer of such transactions in the future. For example, transactions reflecting adjustments to borrowers' accounts were not numbered in such a way that the adjustment could be traced back to the original transaction being adjusted. Now, the adjustment is linked to the original transaction, making it easier for the servicing system to trace adjustments to borrowers' accounts.

EDS Changes Relate to Processes and Systems

EDS has also taken new steps in its process for consolidating loans since the August 1997 shutdown, including adding three new quality control teams, making system changes, experimenting with electronic data submission, and conducting an evaluation of the changes. These changes affect applications that have been received since the reopening of the consolidation program in December 1997.

According to EDS and Education officials, EDS has expanded and redirected staff to provide quality control at three points in the consolidation process. At the front end of the consolidation process, EDS has put in place a team called the exam entry team, which will examine application information to make sure it is ready for data entry. According to EDS, the first place in which problems developed in the consolidation process was its use of incomplete or inaccurate loan information shown on the application. It said that obtaining complete and accurate applications from borrowers is critical to making consolidation work. Therefore, exam entry staff will be working more closely with borrowers and using a variety of other information sources to ensure that information about a borrower's loans, such as lender's name and address, is complete and accurate. Exam entry staff will be matching application materials with data keyed into EDS' data system. Staff will be looking for keying errors and the accuracy of the loan holder's information. When information is missing or inaccurate, staff will attempt to be more aggressive than in the past by using available sources, including telephoning the borrower, to get complete and accurate loan information. Staff also make use of the National Student Loan Data System—an Education system that contains current student loan information for borrowers—to obtain information on a borrower's loan holders. Finally, EDS now requests applicants to include with their application a copy of a page from their payment book or a servicing notice for each loan they are consolidating.

EDS has set up a second team to help reduce the inventory of outstanding verification certificates and to keep the inventory low. The certification team receives a daily report of verification certificates that are overdue. According to EDS staff, certification team members, who are organized geographically and assigned to specific lenders, work with lenders that have overdue verification certificates to get the certificates returned quickly. Certification team members also work with lenders who return incomplete certificates.

In its final quality control in the consolidation process, EDS has set up a third team, referred to as the promissory note underwriting team, to review all borrower application documentation before it pays lenders and issues borrowers a promissory note. According to EDS staff, this team was set up during the shutdown to provide a critical quality review before a borrower's loans are consolidated. Promissory note underwriting staff trace loan amounts shown on promissory notes back to the verification certificates, the original application, and any supporting documentation to ensure that the promissory note amount is correct. Only after a borrower's loan application has been reviewed and approved by the promissory note underwriting team can a promissory note be sent to the borrower and the consolidation loan made. Currently, the promissory note underwriting team reviews all applications before notes are made final and sent to borrowers. However, according to Education and EDS representatives, eventually the team will be reviewing a sample of each batch of applications that make it to this stage. EDS staff cautioned that while promissory note underwriting staff should reduce errors, some mistakes can still occur since much of the underwriting staff's work is based on judgment.

In addition to these three teams, EDS representatives said that they have made changes to its automated system that they believe will help reduce errors. Since the shutdown, 86 Education-requested changes to the system—called direct modification requests—have been implemented. The changes include measures aimed at preventing such things as the use of duplicate SSNs, incorrect calculation of loan collection costs on certain defaulted loans held by guaranty agencies, and data from duplicate loan applications being entered for a single borrower.

EDS representatives also said they are working with selected lenders to allow the electronic submission of verification certificate information. In a pilot project currently under way, a lender submits loan information to EDS on computer diskettes. EDS said electronic submission of this information should save staff time for both lenders and EDS and will avoid the need to manually copy information onto the form. EDS said that this should also increase the accuracy of loan information.

Finally, both Education and EDS officials said that EDS is monitoring the recently implemented changes to its consolidation process through an extensive review of the first applications processed through the new procedures. Since the reopening of the consolidation process in December 1997, EDS has been tracking the first 1,000 consolidation applications, and it hopes its evaluation of these applications will provide information on how well the new changes to the process are working. According to EDS officials, the review will follow each application from the point it is first received from a borrower through loan verification, generation of a promissory note, and, finally, loan payoff and transfer to the FDLP servicing system after the signed promissory note is returned. The review will track how much time applications are spending in each stage of the process. EDS officials also said that the review will use a sample drawn from the first 1,000 applications to determine whether payment accuracy has improved and whether any postdisbursement adjustments have been correctly recorded in the servicing system. Although the evaluation's results were to be available in mid-January 1998, EDS had not fully completed the evaluation in March 1998, when we completed our audit work.

We contacted each of the four lenders included in our study to get their initial reaction to Education's and EDS' changes. The representatives we spoke with offered mixed reactions to the changes and said that it is too early to tell whether they will lead to improved outcomes. One lender's representative noted that, although she has noticed fewer duplicate certificates since the program reopened to new applicants on December 1, 1997, some certificates are still sent to the wrong addressee. Representatives from a lender that is experimenting with electronic transmission of verification certificate data are optimistic that this process will help resolve verification certificate problems, but they are still working out details with EDS. Representatives from all four lenders said that they continue to receive inaccurate payments. However, they said that they cannot determine whether these are for borrowers who were part of the backlog or new applicants since December 1, so they do not know whether the new process is leading to more accurate payments.

Conclusions

EDS' errors in processing FDLP consolidation applications led to a number of problems; lenders had to spend additional time resolving the problems, and borrowers' applications were not always processed correctly. In addition, Education's management and oversight of the FDLP consolidation program failed to ensure that borrowers' applications were processed correctly, and it insufficiently managed the transfer of data between two contractors, EDS and CDSI/AFSA, to ensure that borrowers' accounts reflected what they actually owed.

The changes that Education and EDS are putting into place appear to move in the right direction to address some of the concerns that lenders raised, such as duplicate verification certificates and payment mistakes. However, most of the changes are recent and have not yet been evaluated, and improved outcomes are not yet ensured. Lenders' representatives we spoke with generally believe it is too soon to determine whether they will see fewer problems now that EDS has resumed taking applications and made process changes.

EDS' current evaluation—consisting of 1,000 applications—will test many of the new processes, but we cannot judge whether payoff accuracy and the quality of information being transferred to the servicing system have improved. Because EDS continues to rely on lenders notifying it of inaccurate payments, it does not know whether payoffs are accurate until several weeks after it makes disbursements to lenders, to allow time for a refund or a claim for underpayment. According to EDS officials, the evaluation of the first 1,000 applications will include an analysis of payment accuracy, and we believe that no conclusion can be reached on systems improvements until this analysis is complete. In addition, EDS said that the review will test whether borrowers' accounts with the FDLP servicing system are accurately adjusted for any refunds lenders make—another process that has not always been completed successfully. Finally, we are concerned that the new process changes do not address previous applications—from before the shutdown—that had errors during their processing, such as those in our sample that have not yet been corrected. However, for the examples we reviewed, if all transactions that were placed into suspense files can be correctly applied to borrowers' accounts, most or all errors on the applications would be resolved.

Agency Comments and Our Evaluation

The Department of Education, in commenting on a draft of our report, stated that the report presents a fair analysis of the problems we discuss. Education emphasized that new processes, most of which we discuss, should resolve the types of problems lenders experienced during EDS' first year operating the program. Education offered a clarification to our analysis of the problems involved with transactions that were not applied to borrowers' accounts in the servicing system, and we revised the draft to reflect the clarification. In addition, Education provided several technical comments, which we incorporated as appropriate. Education's written comments are in appendix III.

We are sending copies of this report to the Secretary of Education, the appropriate program manager for EDS, appropriate congressional committees, and others who are interested. If you or your staffs have any questions or wish to discuss this report further, please contact me or Jay Eglin, Assistant Director, at (202) 512-7014. Major contributors include Nancy Kintner-Meyer and James W. Spaulding.

Carlotta Joyner

Carlotta C. Joyner
Director, Education and
Employment Issues

Contents

Abbreviations

CDSI/AFSA	Computer Data Systems, Incorporated/AFSA Data Corporation
EDS	Electronic Data Systems
FDLP	William D. Ford Federal Direct Loan Program
FFELP	Federal Family Education Loan Program
SSN	social security number

Scope and Methodology

We interviewed officials from four judgmentally selected Federal Family Education Loan Program (FFELP) lenders. We selected the lenders to obtain variety in size, as measured by FFELP loan volume, and different perspectives on lenders' experiences with William D. Ford Federal Direct Loan Program (FDLP) consolidations. Two performed third-party servicing (under contract) for other lenders and also had other parties perform servicing for them, and the two others serviced all their loans and no loans for other lenders. One was affiliated with a guaranty agency. Although we tried to obtain a variety of examples, these lenders were not representative of all FFELP lenders.

We visited each lender and interviewed officials who were familiar with FDLP consolidations. The officials described their problems with consolidation processing. They also provided us with documentation on specific examples of problems with the verification certificate process, overpayments, and underpayments. We selected between 8 and 13 examples from each lender for a total of 40.

We discussed with Electronic Data Systems (EDS) and the Department of Education the problems the lenders raised. We also visited EDS and obtained its documentation for each of the 40 examples we had selected. We reviewed some of these cases in detail with EDS to obtain its perspective on the problems the lenders raised.

We discussed, and when possible obtained documentation on, changes both Education and EDS were making to the FDLP consolidation process. We then interviewed the lenders' officials again to obtain their impressions of whether these changes might lead to improvements in the process.

Finally, we obtained servicing history information for some of the borrowers' accounts included in our examples. We noted whether refunds made on a borrower's behalf from EDS to the lender were properly credited to the borrower's account. We obtained these data from Education and Control Data Systems, Incorporated/AFSA Data Corporation (CDSI/AFSA).

The information we obtained is specific to the four lenders we selected and cannot be generalized to all FFELP lenders. We did not select a random sample of cases from these lenders; rather, the lenders nominated cases for our review on the basis of their perceptions of problems in the program. For this reason, we cannot make judgments regarding the overall frequency or extent of these problems in the program as a whole.

Additional Details on Examples of Problems

This appendix contains more detailed analysis of some of the examples cited by lenders involving overpayment and underpayment problems. In addition, we present details on some examples of borrowers whose accounts with the FDLP servicing system were incorrect at the time of our review, and we include other comments lenders made about the FDLP consolidation process.

Overpayments to Lenders Had a Variety of Causes

EDS officials said that one cause of overpayments was that EDS mistakenly sent multiple verification certificates to lenders and that lenders returned them. EDS would pay lenders on the basis of certificates that were returned. So at times, if EDS received a certificate, paid off a borrower's loan account, and subsequently discovered that it had received another completed certificate it had sent to a lender, it would make a second payment to the lender. For example, one lender returned two certificates for a borrower, verifying two loans, one in March 1997 and one in April. EDS sent two checks, one for each loan, on April 10 and two more—which constituted double-payments—on May 15.

In addition to multiple verification certificates, EDS data entry errors, made while entering data from verification certificates into the data system, subsequently led to overpayments. In one example, an EDS representative said that one of three loans a borrower wanted to be consolidated, for $16,715.09, was entered in EDS' data system as a $167,115.09 loan. However, one of the two other loans, for about $41,000, was entered into the system and subsequently overwritten by an erroneous entry of only $5,000. EDS sent checks totaling $179,531.53 for the three loans, constituting a net overpayment of about $114,000, which the lender refunded to EDS.

In another example, a lender listed a borrower's four loans on a verification certificate as totaling $29,565.97. The first of the four loans was for $10,953.91, but EDS data-entered it as $19,953.91 by mistake. In EDS' system, this error, combined with slight overpayments for the three other loans, made the total for the four loans almost $40,000, which EDS paid the lender, resulting in a $10,000 overpayment.

Verification certificates include a box showing the total amount of the loans being certified. In each of these cases, had EDS staff checked the box showing the total, the data entry error on the individual loan would have been apparent.

Other EDS processing errors contributed to overpayments. In one example, a borrower had three subsidized Stafford loans totaling $17,000. The verification certificate the lender returned to EDS showed the borrower's graduation date of May 1997. Because they were subsidized loans, the lender filled in "zero" for interest due on each loan, with a note saying "info good thru 11/30/97," the end of the borrower's grace period. Despite the lender's notation on the certificate, EDS added interest to the payment, which it made in October 1997. The interest covered 36 days, and the checks were sent out 32 days after the date on the certificate, so enough interest was added to cover 4 days of mailing time. Although small, the interest amounts constituted overpayments.

In all overpayment cases we analyzed, borrowers signed promissory notes for amounts that exceeded what they owed, which means that borrowers might have been liable for repaying the inaccurate amount on the promissory notes. In some of these cases, a borrower signed two very similar promissory notes, sometimes within several weeks of each other, and EDS paid lenders for the same loan twice. In other cases, the borrower signed only one promissory note that covered the same loans twice or contained other errors. In still other cases, borrowers signed as many as five promissory notes, each one partially covering their loans but totaling far more than what was owed.

Underpayments Also Had a Variety of Causes

Underpayments generally resulted from lenders' data not being entered into EDS' data system. Typically, a lender certified a number of loans for a borrower, and EDS entered data for all but one of the loans, or data that were entered for a loan were subsequently overwritten. EDS did not pay the omitted loan, and the borrower's account with the lender could not be closed out because the system showed that a loan remained unpaid.

For example, one borrower had 10 loans with a lender. Five of the loans were included in a promissory note EDS mailed to the borrower in March 1997, which the borrower signed and returned the following month. EDS sent the lender four checks on April 17 and sent a check for the fifth loan on October 7. EDS sent a second promissory note in October, which was signed and returned that month, and EDS sent the lender three additional checks on October 20. Finally, the last two loans were included on a third promissory note, and EDS sent payment for these on December 12.

Some underpayments resulted from an edit check EDS put into place to reduce the likelihood of a duplicate payment. The edit check would not allow a borrower to have two loans in the data system with the same "first disbursement date," mistakenly assuming that if two loans showed the same disbursement date, they were actually the same loan. As EDS staff entered loan data into the data system from a verification certificate, if one loan had the same disbursement date as another loan already entered, the system would overwrite the previously entered data rather than creating data for a new loan. This edit led to EDS underpaying several lenders because it did not pay off at least one loan that a borrower intended to consolidate.

In one example, a borrower had five loans with a lender, but two had the same first disbursement date. During data entry, the second of these overwrote the first loan, which was for about $19,000, so the first was not included on the initial promissory note. The certificate was returned to EDS in August 1997, EDS sent out the initial promissory note in September, and EDS sent payment to the lender for four loans on October 20. After a second promissory note, covering the last loan, was signed and returned, EDS sent a check for the last loan on December 10.

In another example, a borrower had three loans with the same disbursement date, and only one of them was entered into the system—the two others were overwritten. Thus, EDS did not pay these two loans and underpaid the lender for that borrower's loans.

EDS Data Entry Errors Led to Some Payments Sent for Wrong Borrower or to Wrong Lender

Lenders' representatives said that other kinds of payment mistakes caused them problems. In cases in which verification certificates were sent to the wrong lender or to an incorrect lender address, EDS would also sometimes send its payments to the same mistaken address. This might happen because the lender did not correct the initial mistaken address. However, in other examples the lender had corrected the address but EDS did not enter the corrected address into its system. A payment, or other correspondence, was then sent to the same mistaken address to which the certificate had been sent.

Another source of mistaken payments concerned misidentification of loans in default at the time of consolidation. FDLP allows defaulted loans to be consolidated under certain circumstances; any costs incurred to collect the defaulted loan, up to 18.5 percent of outstanding principal and interest, are to be added to the borrower's amount to be consolidated. Three data fields in EDS' data system should have helped ensure that such loans could be identified. These fields showed (1) whether the loan was in default, (2) whether the loan holder was a private lender or a guaranty agency, and (3) whether collection costs were due. EDS' records did not always contain consistent information in these fields. For example, for loans that were not in default, the system should have shown that the loan holder was a private lender and no collection costs should have been assigned. However, for one of the examples we analyzed, the data system showed that the loan was not in default but it showed that the borrower was assigned collection costs. In this case, the loan actually was in default but the system did not identify the inconsistency in the data. Because EDS' data system used only information in the "loan default" field to compute its payment amount, and it did not separately look at the field showing whether any collection costs were due, the collection costs were not paid. EDS underpaid the lender for this loan, and it will have to process an adjustment to pay the lender for its collection costs.

Perhaps the most serious examples of problems were those in which loans in two borrowers' accounts were intermingled. In these instances, at some point in EDS' process of entering loan data into one borrower's account, EDS staff erroneously entered loan data pertaining to a second borrower. In EDS' system, the first borrower's account then included a loan with the first borrower's social security number (SSN) in the SSN field but a second borrower's SSN in the "account number" field.[9] The checks EDS sent to lenders similarly listed the first borrower's name and SSN, but they had the second borrower's SSN in the "account number" field.

One borrower owed less than $100,000 but signed five promissory notes for a total of $190,000. For this borrower, EDS made some data entry errors, but it also entered data pertaining to a second borrower's loans into this borrower's account. Because of these errors, EDS overpaid the lender by more than $90,000 on this borrower's account, with about $47,000 of this excess stemming from loans that belonged to the second borrower. When the lender received the checks, it saw the second borrower's SSN, saw that the second borrower's account had already been paid in full, and returned the checks to EDS.

[9]EDS' data system had fields for both "SSN" and "account number" to record data about borrowers that EDS received from the lender. Many lenders used the borrower's SSN as the account number, so these fields should have contained the same data. Some lenders assigned a completely different account number, so these fields would differ. For checks issued after August 1997, both the SSN and the account number pertaining to a loan, as well as the first disbursement date, were printed on the check paying off that loan.

In all, we found four examples of this type of error. In the second example, EDS sent three checks to a lender for a borrower with two loans. The third loan had a different nine-digit account number, which was the SSN of a different borrower whose loans were with the same lender. In the third example, a lender received five checks, each for less than $500, for one borrower but with another borrower's SSN. In this example, the second borrower did not have any loans with that lender, so the lender did not recognize the account number as another borrower's SSN. In the fourth example, only one check, for less than $1,000, was sent for the first borrower with the second borrower's SSN. In this example, however, EDS sent a loan verification certificate for the second borrower that included the first borrower's SSN in the "account number" field, so EDS apparently confused these two borrowers' applications before the certification stage.

System Glitches Led to Overpayments Not Promptly Corrected in the FDLP Servicing System

Mistakes in transferring completed consolidations to the FDLP servicing system meant that overpayments returned by lenders were not always corrected in a borrower's servicing account. According to Education officials, data on completed consolidations are not always smoothly transmitted between the system maintained by EDS and two systems maintained by the loan servicing contractor. Because the systems have different edit checks, data on completed consolidations can be rejected by the system receiving the information and are placed in a "suspense" file of rejected transactions. Some of these transactions can eventually be applied automatically, while others must be dealt with manually. Education officials said that EDS has been working on cleaning up this file of rejected transactions since October 1997.

We analyzed some examples in which lenders' overpayment refunds to EDS were not applied to the borrower's account in the FDLP servicing system. The borrower we discussed earlier who had signed promissory notes totaling about $190,000, for example, was shown in FDLP servicing system records in February 1998 as owing $190,000, even though the lender who received the overpayments made refund payments to EDS totaling over $90,000, in May and September 1997. Also, for one borrower whose $58,000 loan EDS had paid twice, FDLP servicing system records continued to show the additional $58,000 as part of her loan balance in February 1998, although EDS received the lender's refund in May 1997.

In most examples we analyzed in which borrowers had not been credited for refunds made on their behalf, we verified that EDS received a refund, but we could not determine whether the refund transaction had been forwarded to the direct loan servicer, CDSI/AFSA, for posting in the FDLP servicing system. However, in one case we determined that information reached the FDLP servicing system but had not been properly recorded. In this case, a lender sent 15 refund checks to EDS for overpayments it had received. The whole dollar amounts for 13 of the 15 checks—but not the cents amounts—were recorded in the servicing system in June and July 1997. The cents amounts for all 15 checks were recorded in December 1997 but not the whole dollar amounts for the remaining 2 checks, totaling about $19,000. Thus, all 15 checks were received by the FDLP servicing center, but the whole dollar amounts for the 2 unrecorded checks had not been credited to the borrower's account as of February 1998. As a result, the borrower's outstanding balance was about $19,000 more than it should have been.

Also, the system did not always ensure that subsidized loans correctly retained their subsidy after consolidation. Consolidation loans can contain a subsidized and an unsubsidized portion. If a borrower were to return to school or obtain certain other deferments, interest would accrue on the unsubsidized portion but not on the subsidized portion. The borrower described earlier with a net overpayment of about $114,000 because of two data entry errors had refunds properly posted to his account. His account showed that he owed about $65,000, the correct amount. However, his entire balance was shown as unsubsidized, even though about $40,000 of the $65,000 should have been subsidized. The two EDS data entry errors, and the manner in which refunds were applied, resulted in his subsidized loan being overwritten.

Communication Problems Attributed to EDS Unfamiliarity With Program and Lack of Priority Placed on Consolidation

Some lenders' representatives also expressed frustration at what they believed was a lack of communication from Education and EDS. Lenders attributed this to EDS' newness to the student loan arena and apparent lack of familiarity with lenders. Lenders also said that while they had complained to Education staff about various problems with the consolidation process, no resolution had yet been reached.

One lender's representative said that lenders were provided no advance notice from either Education or EDS of the August 1997 shutdown of the FDLP consolidation program. After the shutdown, lenders were not provided any information about when consolidation operations might resume. The lender's representative also said that toward the end of the shutdown, with no advance warning, the lender suddenly received an avalanche of loan payoff checks—far more than the usual volume—which it found difficult to process.

Lenders also said that EDS' customer service to lenders had been uneven. One lender's representative said that after her contact at EDS left the company, she had had difficulty for more than 2 months finding another contact to help resolve problems. Another lender's representative said that EDS did not provide follow-up to her calls and that she usually had to initiate follow-up calls. A third lender's representative said that he had difficulty finding someone at EDS to assume responsibility for resolving his problems. His calls to EDS were transferred from person to person, ultimately leaving his problem unresolved.

Lenders' representatives said that while they had discussed problems with Education officials during EDS' first year of direct loan consolidations, they had not heard back about any resolution. Education officials acknowledged that during EDS' first year of direct loan consolidation, it did not do a good job of working with lenders on the consolidation process. These officials suggested that consolidation did not receive needed staff time to ensure the process was running smoothly because of other priorities within Education.

Comments From the Department of Education

UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF POSTSECONDARY EDUCATION

THE ASSISTANT SECRETARY

Carlotta C. Joyner
Director, Education and Employment Issues
United States General Accounting Office
Washington, D. C. 20548

APR 3 1998

Dear Ms. Joyner:

Thank you for the opportunity to comment on your draft report entitled Direct Student Loans: Efforts to Resolve Lenders' Problems with Consolidations Are Underway regarding problems lenders experienced consolidating student loans under the William D. Ford Federal Direct Loan Program (FDLP), and the steps the Department and our contractor, Electronic Data Systems (EDS), have taken or are planning to address these problems and solve them.

Like other financial institutions, the Department recognizes that developing a sound process for consolidating loans is a complex and arduous task. Indeed, we find that most Federal Family Education Loan Program lenders avoid student loan consolidations. Consolidating student loans is like consolidating several mortgages on a home, hundreds of times a day. Every consolidation may involve multiple parties, including the consolidator, the borrower, credit bureaus, guaranty agencies, and, experience is showing an average of three lenders. Erroneous, incomplete or late information from any of these parties delays the consolidation. Also, because loan balances are constantly changing due to the accrual of interest and borrower payments, a lag in the reporting of any piece of information can become a real obstacle to timely and accurate loan consolidation.

The draft report presents a fair analysis of problems EDS experienced in its first year operating the dirct loan consolidation program. In August 1997, we asked EDS to temporarily stop accepting new loan applications so that it could correct deficiencies in its process and complete the applications that had accumulated. On December 1, 1997, EDS resumed accepting new loan consolidation applications.

Between August and December, the Department took strong action in collaboration with EDS and the independent quality control unit for the contract, Price Waterhouse, to re-design and improve EDS's direct loan consolidation process. The Department developed short and long range plans to re-engineer and enhance basic processes and devote additional resources to process applications and address other consolidation process problems. These process improvements and systems enhancements include:

Re-engineered the loan certification process. By capturing better data early on in the process, adding improved monitoring features, and providing a point of contact for loan holders, we have realized a significant reduction in the inventory of outstanding or mis-directed certifications.

600 INDEPENDENCE AVE., S.W. WASHINGTON, D.C. 20202-5100

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

Established new management controls. By establishing a management team dedicated to FDLP consolidations, we have ensured that student loan consolidations have the necessary focus. In addition, new management information system reports were developed to assist in monitoring the aging of applications.

Enhanced data accuracy and timely correction of errors. By improving the flow of data between EDS and other Title IV contractors, fewer problems are associated with information in borrowers' accounts. In addition, we anticipate that additional internal controls put in place by EDS and improved document imaging and procedures will result in fewer problems associated with inaccurate data entry. Promissory note underwriting now also captures errors which may have been overlooked in the past.

Modified our contract with EDS to include performance measures. By amending the EDS contract to a performance-based model we will ensure improved products, quality, and services. Current reports indicate the contractor is performing within expected time frames.

Developing systems improvements. Developing a process for electronic pay off of loans to loan holders will ensure more timely and accurate disbursement; increasing the number of electronic interfaces with loan holders will improve data accuracy and timeliness. Developing a backup system will ensure internal controls are in place should the contractor be unable to maintain adequate performance or should documentation exceed the contractor's agreed upon capabilities.

Attachment A contains specific comments on three major issues raised in the report. Again, thank you for the opportunity to review and comment on this report. The problems identified as affecting loan holders obviously affect borrowers too and we are committed to resolving these issues with our partners in student loan management. If you have any questions, please contact Ann Byrd at 260-5294.

Sincerely,

David A. Longanecker

Attachment A

SPECIFIC COMMENTS ON
MAJOR ISSUE AREAS

Verification certificates with incorrect information or incorrect addresses

Initially, the FDLP consolidation process assumed that the borrowers would accurately identify loan holder information and that the system could generate certifications using the address information either supplied by the applicant or present in the lender file maintained by the Department. However, experience has shown that these assumptions were not necessarily valid. This is because of the dynamic nature of the student loan industry: mergers, sales of individual loans or entire loan portfolios, similarities in lender names, the ability of the applicant to distinguish between the holder of the loan and the entity that services the loan, address differences between the point of contact for student loan administration and the point of contact for providing loan pay off information are examples of the challenges inherent in the procedures for accurately determining what information is to be included on the certificates and where those certificates are to be sent.

In addition, although the Department maintains a lender file which contains addresses and other information for lenders, schools and servicers, this information is subject to frequent change. In response to the challenge of improving the accuracy of verification information, EDS has implemented an exam entry review process early in the application stage to ensure more accurate identification of correct information. In addition, the combined efforts of the exam entry review team in the early application stages and a certification team in a later stage to monitor and provide a point of contact for loan holders, have resulted in significant reductions in the inventory of outstanding or mis-directed certifications.

Multiple certifications and inaccurate payments

Before the process was re-analyzed and sufficient controls put into place, there was the potential for sending multiple requests for certifications, as well as, multiple payoffs to the same lender for underlying loans. While these errors could be identified after they occurred, they nevertheless caused inconvenience and frustration to the loan holder community and potential harm to the borrowers who did not realize their accounts were in error. New system controls and procedures should reduce these problems significantly. For example, double data entry of documents, improved imaging and new manual procedures should result in fewer errors in key data fields. In addition we are encouraging loan holders to use an EDS-supplied automated certification diskette to eliminate potential errors resulting from illegible handwritten forms

Finally, promissory note underwriting--that is, the review of all promissory notes and their underlying detail before mailing to borrowers--should also capture errors which may have been overlooked in the past.

With respect to underpayments, additional edits have been put in place to identify accurately when collection costs are to be paid and to assure that the calculation of those costs are accurate. Additional guidance was provided to loan holders concerning the need for them both to identify all educational loans held for requested borrowers (not just those listed on the verification certificates) and to correct the verification certificates with respect to the type of loans and current loan amounts.

The FDLP Servicing System Did Not Always Reflect Adjustments to Borrowers Accounts

The draft report characterizes the relationship between EDS and the FDLP Servicing center as incompatible. That description is not accurate. These systems exchange data. There are transactions that are rejected when moved from one system to the next. However, the data from these transactions are not lost or inaccurately captured but moved to a suspense file until they are resolved. The Department, through its contractors, recognizes the potential problems that occur when borrowers' accounts do not reflect what they actually owe and has developed a methodology and a plan to capture transactions for future processing. While account balances, such as those cited in the draft report, do not reflect all adjustments and disbursements that are to be made, transactional data are captured and continue to be applied to borrower accounts. Most problems with these transactions have now been corrected, and we anticipate the remainder will be completed by the end of May.

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