United States General Accounting Office

GAO

Report to the Honorable
James M. Jeffords, U.S. Senate

March 2002

DIRECT STUDENT LOANS

Additional Steps Would Increase Borrowers' Awareness of Electronic Debiting and Reduce Federal Administrative Costs

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GAO-02-350

United States General Accounting Office
Washington, DC 20548

March 29, 2002

The Honorable James M. Jeffords
United States Senate

Dear Senator Jeffords:

In November 1999, the Department of Education (Education) began offering a 0.25 percent interest rate reduction under the William D. Ford Federal Direct Loan Program (FDLP) to borrowers who agree to have their monthly loan payments automatically withdrawn from a bank account via its electronic debit account (EDA) program. While borrowers would benefit by paying a reduced interest rate on their loans, the federal government would benefit from receiving fewer late payments. The Higher Education Act of 1965, as amended, requires that such interest rate reductions be "cost neutral and in the best financial interest of the Federal Government" and that Education offset any higher subsidy costs[1] resulting from the interest rate reduction through reductions in funding for administrative costs.

In a cost justification it submitted to the Congress in August 1999, Education stated that the loss of revenue to the federal government from offering the reduced interest rate would be more than offset by a gain in revenue because some EDA borrowers who had previously paid by check would stop making periodic payments in excess of their scheduled amount due. By ceasing to make these prepayments, these borrowers would not pay off their loans as soon as they would have without signing up for EDA and, therefore, incur additional interest costs over the life of their loans. Education assumed about half of the borrowers making prepayments prior to enrolling in EDA would discontinue making prepayments after enrolling in EDA. Education found that eliminating these prepayments could potentially extend the time some borrowers were repaying their loans by

[1] Subsidy costs are the net present value, at the time a direct loan is disbursed, of the cash flows for loan disbursement, repayments of principal, and payments of interest and other payments by or to the government over the life of the loan after adjusting for estimated defaults, prepayments, fees, penalties, and other recoveries. Present value is the worth of the future stream of returns or costs in terms of money paid immediately—prevailing interest rates provide the basis for converting future amounts into their "money now" equivalents.

1-½ years. In effect, EDA borrowers who stopped prepaying would lose some portion of their interest savings from the rate reduction. Thus, Education's analysis appeared to justify savings to the government at additional cost to some borrowers enrolling in the EDA program, rather than by reducing administrative costs associated with processing payments by check. Because of your concern about the possibility that some borrowers would pay additional interest under EDA, you asked us to determine the following:

- To what extent have assumptions concerning borrower behavior used in Education's cost justification materialized?
- To what extent has Education informed borrowers of the possible cost implications of EDA participation and the options that are available to them for prepaying their loans?
- To what extent has Education achieved administrative cost savings as a result of the program?

In conducting this work, we interviewed Education officials and collected and analyzed cost and other pertinent information. To examine the extent to which Education's cost justification assumptions about borrower behavior—the percentage of EDA borrowers that would enroll in EDA and the percentage that would change their prepayment patterns after enrolling—materialized, we reviewed Education's cost justification, discussed its preparation and methodology with the Education officials who developed it, and obtained and analyzed available information about the repayment behavior of borrowers who have enrolled in the EDA program. To identify the information Education had provided borrowers about possible cost implications of EDA participation and prepayment options associated with EDA, we obtained and reviewed all Education direct loan repayment information available to borrowers. To estimate administrative cost savings, we reviewed Education and Department of the Treasury (Treasury) cost data associated with billing EDA and non-EDA borrowers and processing their payments. We discussed our analysis with officials at both agencies to ensure that we included all appropriate cost items. We conducted our work between March 2001 and February 2002 in accordance with generally accepted government auditing standards.

Results in Brief

While actual EDA enrollments have exceeded its original assumptions, Education lacks readily accessible data showing how borrowers have changed their prepayment patterns after enrolling in the program. In its cost justification, Education assumed, on the basis of reported private sector experiences with electronic debit payments, that 5 percent of direct loan borrowers would enroll in its EDA program. As of September 2001, the actual percentage of direct loan borrowers who enrolled in the EDA program was almost 12 percent. On the other hand, whether Education's other assumption about borrower behavior has materialized is unknown. Because private lenders' experiences with EDA-like programs varied widely, Education assumed a random distribution of borrowers likely to continue to prepay, with 50 percent of those who had prepaid continuing to do so and 50 percent discontinuing prepayment. However, Education lacks readily accessible data needed to determine whether and how EDA borrowers changed their prepayment patterns. As a result, the extent to which EDA borrowers have been less likely to prepay is unknown.

Education has not informed borrowers of the possible cost implications of EDA participation nor has it systematically informed borrowers of their prepayment options. Specifically, Education has not informed EDA borrowers that they may pay more interest over the life of the loan than they would have paid without EDA because only the scheduled payment amount is withdrawn when EDA is initially established. In May 2001, Education posted information on the direct loan servicing Web site indicating that EDA borrowers could mail supplemental payments to the direct loan servicer. However, Education has not systematically disseminated information about this and other prepayment options available to all borrowers. Moreover, when we reviewed Education publications to identify the EDA disclosures made to borrowers, we found that Education has not updated information to reflect the reduced interest rate borrowers receive if they repay their loans through EDA, even though Education began offering the discount in November 1999.

We estimate Education achieved administrative cost savings of about $1.5 million in fiscal year 2001, primarily because it did not have to mail and generate bills to EDA borrowers. While reviewing Education's cost data to estimate its administrative cost savings from EDA, we identified an unrelated potential opportunity for additional administrative cost savings. The direct loan servicer charges Education a separate fee for servicing delinquent accounts. Even though the servicer does not take any action to collect on past due accounts until they are 7 days late, it still assesses this fee for the first six days any payment is overdue. In addition to savings to Education, we also identified savings associated with EDA to the Department of the Treasury, which processes direct loan payments for Education and incurs most of the associated costs. In fiscal year 2001, we estimate Treasury saved about $1.2 million because processing payments electronically, according to Treasury, costs approximately 99 percent less than processing payments by check.

In this report, we make recommendations that Education take steps to better inform borrowers of the options available to them to prepay their loans, to better publicize EDA in order to maximize administrative savings, and to consider renegotiating certain fees its pays its loan servicer.

In written comments on a draft of this report, the Department of Education generally agreed with the information presented as well as our conclusions and recommendations. Education's comments are reprinted in Appendix I. Education also provided technical comments, which we incorporated where appropriate.

Background

The FDLP legislation was enacted in August 1993 as part of a broader reform of the federal student loan programs. The first direct loans were made in fiscal year 1994. FDLP makes it possible for students and their families to borrow directly from the federal government through the colleges or other postsecondary institutions the students attend. As of September 30, 2001, about 3.6 million borrowers were repaying more than $45 billion in direct loans. Education services FDLP loans through a contract with Affiliated Computer Services, Inc. (ACS), an information technology systems and services company. As prime contractor, ACS has overall responsibility for FDLP loan servicing. ACS has a subcontract with Academic Financial Services Association Data Corporation (AFSA), under which AFSA has the main responsibility for FDLP loan-servicing operations. [2] Education has an interagency agreement with Treasury for processing direct loan payments. Treasury, in turn, has agreements with and compensates certain commercial banks for processing both paper and electronic payments made by the public to federal agencies. Treasury bills federal agencies only for those services that it considers outside the basic level of service negotiated with the designated commercial banks. In fiscal year 2000, Treasury charged Education $26,353 for these ancillary services. Specifically, this amount was charged for the cost of shipping reports and other material by overnight mail to Education.

In February 1998, Education implemented EDA to allow FDLP borrowers to have their loan payments automatically withdrawn from a bank account each month. Then, in November 1999, Education began offering a 0.25-percentage point reduction in the interest rate to borrowers who agreed to

[2] AFSA also provides student loan servicing for banks and secondary markets under the Federal Family Education Loan Program—the largest federal student loan program.

repay their loans this way. The number of borrowers who made their loan payment through EDA went from 40,023 in October 1999, before the discount went into effect, to 364,704 in September 2001.

The cost justification model Education developed used eight key assumptions. These assumptions included such things as the interest rate charged to borrowers, the number of outstanding loans, and two assumptions concerning borrower behavior—estimates of how many borrowers would likely enroll in the program once it was established and the likelihood that borrowers would continue to prepay their loans after enrollment. As the basis for developing these assumptions, Education relied on a variety of factors, including prevailing Treasury interest rates, private sector experiences with electronic debit repayments, conventions economists generally use in the absence of data, and analysis of its student loan portfolio. Table 1 shows the eight key assumptions used in Education's cost justification model and the basis of each assumption.

Table 1: Key Assumptions Used in Education's Cost Justification Model and Their Basis

Assumption	Basis of assumption
Borrower interest rate—Average loan interest rate across all borrower cohorts in the FDLP.	Analysis of loan portfolio data maintained in the National Student Loan Data System (NSLDS), and the Direct Loan Servicing System (DLSS), and interest rates published by Treasury.
Discount rate—Interest rate used to calculate the net present value[a] of FDLP student loans over time.	Average rate for credit accounts as published by Treasury.
EDA program enrollment rate—Rate at which FDLP borrowers would enroll in the EDA program.	Behavioral assumption made by Education based upon reported private sector experience.
Continued borrower prepayment—Percent of FDLP borrowers likely to continue to prepay their loans.	Behavioral assumption made by Education under conditions of uncertainty. Education assumed a random distribution in light of mixed results reported by private sector lenders. Borrowers whose student loan payment histories showed they were ahead of schedule in their loan payments were identified as borrowers who were prepaying.
Average total time to maturity—Average time in years to loan maturity for borrowers both assumed to continue and assumed to discontinue prepaying under EDA.	Analysis of loan portfolio data maintained in the NSLDS and the DLSS.
Time since entering repayment—Average time in years since a borrower entered loan repayment.	Analysis of loan portfolio data maintained in NSLDS and DLSS.
Average balance for loans—Average outstanding FDLP borrower loan balances.	Analysis of loan portfolio data maintained in NSLDS and DLSS.
Number of loans outstanding—Actual total number of outstanding FDLP loans.	Analysis of loan portfolio data maintained in NSLDS and DLSS.

[a]Net present value is the worth of the future stream of returns or costs in terms of money paid immediately. In calculating net present value, the discount rate provides the basis for converting future amounts into their "money now" equivalents.

Borrowers have the right to prepay their loans.[3] If a borrower repays any amount in excess of the amount due, the excess amount is a prepayment. Loan repayments, including prepayments, are credited first to any accrued charges or collection costs and then to outstanding interest and principal. Because prepayments generally reduce a borrower's principal balance outstanding, the amount of interest that accrues in subsequent months is also reduced, decreasing the amount of interest the borrower pays over the life of the loan. Borrowers who pay by check can easily make repayments in excess of the amount due, for example, by rounding up their repayment, but EDA borrowers have to take extra steps to prepay because only the scheduled repayment amounts are withdrawn from EDA borrowers' accounts. In practice, the amount due without regard to the 0.25 percent discount is withdrawn. Therefore, EDA borrowers do not receive a reduction in the amount they repay each month, but more of

[3] 20 U.S.C. 1077(a)(2)(F)

each repayment is applied to the principal balance and they will repay their loans faster as a result.

A variety of factors can affect a borrower's decision about whether to prepay a loan. Given that FDLP interest rates for direct loans cannot exceed 8.25 percent and the interest paid is tax deductible for borrowers who do not exceed certain income limits, prepaying may not be the best option for all borrowers. For instance, borrowers who have recently entered the workforce when they begin repaying their loans may not have sufficient resources to prepay their loans. Rather than prepay their direct student loans, some borrowers may also decide to instead repay any higher-interest debt they have accumulated, for which interest paid is not tax deductible, such as credit card debt.

While More than Twice as Many Borrowers Enrolled in EDA than Education Assumed, the Extent to Which They Have Continued to Prepay Their Loans Is Unknown

While more than twice as many borrowers have enrolled in the EDA program than originally assumed, the percentage of EDA borrowers who have continued to make prepayments remains unknown. In developing its cost justification of the EDA program, Education assumed that a certain percentage of borrowers would likely enroll in the program and that a certain percentage of these borrowers would continue to prepay their loans. Education based these assumptions on reported private sector experiences with electronic debit repayments and on conventions economists use in the absence of data. Education lacks data showing borrowers' prepayment patterns before and after enrolling in the program, thus it cannot determine the extent to which its assumption has materialized.

Education's assumption that 5 percent of direct loan borrowers would enroll in the EDA program was an estimate based on the experiences of large, national private sector guaranteed loan lenders' programs similar to EDA. As of September 2001, the actual percentage of EDA enrollees is closer to 12 percent, which, according to Education's cost justification, would increase the savings to the government to over $19 million.[4] Table 2 shows government savings at the originally assumed 5 percent enrollment rate and our estimates of the savings that Education's cost justification model would project if higher EDA enrollment rates were to materialize, keeping the prepayment assumption constant.

[4] As of September 2001, 424,209 borrowers were enrolled in EDA.

Table 2: Estimated Government Subsidy Cost Savings with Different Rates of EDA Enrollment

Enrollment rate	Government savings
5 percent	$7.2 million
12 percent	$19.1 million
20 percent	$31.5 million

Source: Education's cost justification model and GAO analysis based on the model.

Education also obtained information from private sector lenders on their experiences with continued prepayment by borrowers after enrolling in EDA-like programs. Private lenders reported mixed results. For example, one lender reported that 20 percent of borrowers who previously prepaid continued to prepay after enrolling in such a program while another lender reported that 80 percent continued prepaying, according to Education officials. Given the wide variance in reported experience, Education officials concluded that they could not make an assumption based on these data. Therefore, Education assumed a random distribution of borrowers likely to continue to prepay, with 50 percent of those who had prepaid continuing to do so and 50 percent discontinuing prepayment.

While we were able to determine the extent to which Education's assumption about EDA enrollment materialized, we were unable to determine the extent to which its assumption for continued borrower prepayment materialized. Limitations in Education's Direct Loan Servicing System prevented us from obtaining data on borrower history of repayment activity. Education can identify borrowers who are paying their loans ahead of schedule and, therefore, likely to be prepaying. However, it cannot identify EDA participants from this data and it lacks trend data showing how frequently and by how much borrowers prepay their loans. Individual borrower payment activity data are available for only the most recent 2 months. Given that borrowers change their prepayment patterns at their convenience throughout their loan repayment period, these data would not have covered a long enough time period to determine how prepayment patterns have changed. Consequently, we could not compare the overall patterns of borrowers' prepayment behavior before or after enrolling in the EDA program.

Education Has Not Informed Borrowers about the Possible Cost Implications of EDA Participation or Prepayment Options

Education has not informed borrowers of the possible cost implications of EDA participation nor has it systematically informed borrowers of their prepayment options. Education has not told borrowers that because repayment through EDA may take longer, they may incur more interest cost over the life of the loan than if they previously prepaid without EDA. While Education has made some information available to borrowers online about where to send supplemental repayments, it has not systematically informed all borrowers of their prepayment options. Further, Education has not updated its borrower publications to inform borrowers of the option and benefits of repaying their loans through EDA.

Borrowers Are Not Informed about Cost Implications of EDA Participation

Education has not taken steps to inform EDA borrowers that—even with a reduced interest rate—they could pay more interest over the life of the loan. This could happen if prior to enrolling in EDA, they made repayments that exceeded the scheduled amount due, but after enrolling paid only the amount due. When borrowers establish an EDA, there is no place on the application form to designate an amount in addition to the scheduled payment to be withdrawn each month. To continue their prepayments, such borrowers would have to send a check for any prepayment or make arrangements to continue making prepayments through EDA.

Borrowers Are Not Systematically Informed of Their Prepayment Options

The Higher Education Act of 1965, as amended, requires that student loan borrowers be informed that they may prepay all or part of their loans at any time without penalty, but it does not require the disclosure of specific prepayment options. In documents such as the master promissory note and borrower publications, Education informs borrowers that they may prepay their loans. In May 2001, after we began our work, Education added information to the direct loan servicing Web site indicating where EDA borrowers wishing to prepay their loans could send supplemental payments. While this information may help borrowers with Internet access, Education has not disclosed this information in EDA brochures, the EDA application, or the confirmation notice sent to borrowers who establish EDAs. Further, Education does not inform EDA borrowers that they may make routine prepayments, by contacting the direct loan servicer at any time and increasing the amount withdrawn from their bank account each month.

In addition to not disclosing prepayment options, Education had not updated two of its borrower publications to fully reflect the option borrowers have to repay through EDA. One publication, *Exit Counseling*

Guide for Borrowers, does not provide details about how EDA works, the advantages of EDA for making loan payments, or the reduced interest rate EDA borrowers receive.[5] The other publication, *Repayment Book*, which is available to help borrowers understand and select from the available repayment plans, makes no reference to EDA.

Use of EDAs Generated Estimated Administrative Cost Savings of More than $2.7 Million in Fiscal Year 2001 for Education and Treasury

Education and Treasury achieved administrative cost savings because EDAs reduced the costs associated with billing and processing payments. Education saved an estimated $1.5 million in fiscal year 2001 as a result of generating and mailing fewer bills to EDA borrowers. Additional savings are also possible with respect to costs associated with servicing past due accounts. Treasury, which processes direct loan payments and incurs most of the associated processing costs, saved an estimated $1.2 million in fiscal year 2001.

Education Saved on Administrative Costs by Not Sending Monthly Billing Statements to EDA Borrowers

As a result of EDA, Education reduces administrative costs associated with generating and mailing billing statements to borrowers. According to our review of Education cost data, in fiscal year 2001, Education saved about $1.5 million or $0.39 per month for each borrower who used EDA. This savings includes the cost of things such as the paper billing statement, the mailing envelope, and postage. Through EDA, Education avoided sending out more than 3.6 million billing statements over the course of fiscal year 2001. The other administrative costs Education incurs for servicing direct loan accounts are the same for all borrowers, regardless of their payment method. Table 3 shows the specific costs Education incurs for routine servicing of FDLP accounts. EDA should result in additional administrative cost savings by reducing the potential for late payments and accompanying collection efforts, according to an Education official.

[5] FDLP schools are responsible for ensuring that borrowers who are graduating, withdrawing, or otherwise ceasing to attend school at least half time, receive exit counseling.

Table 3: FY 2001 Monthly Costs Associated with Routine Servicing of FDLP Accounts by Payment Method (per borrower)

	EDA account	Non-EDA account
Service accounts	$0.909	$0.909
Post payments	0.475	0.475
Generate and mail bills	0.000	0.063
Envelopes used in billing[a]	0.000	0.054
Postage	0.000	0.270
Total	**$1.384**	**$1.771**

[a]Includes two envelopes per statement mailed. Beginning in May 2001, the cost of envelopes was reduced from $0.094 to $0.074. In July 2001, the cost of envelopes was further reduced to $0.054.

Some of the administrative savings Education achieves with EDA are offset with expenses that Education incurs at Treasury. Education pays Treasury for processing EDA applications. In fiscal year 2000, Treasury charged Education about $128,900 for processing 253,000 EDA applications.

In the course of doing our work, we identified a potential opportunity for additional administrative cost savings unrelated to EDA. Education adheres to a price structure for servicing delinquent accounts that may not be appropriate. Currently, the direct loan servicer assesses Education a separate fee for each day a borrower's account is at least 1 day past due. This fee applies to all late direct loan payments, but because EDA payments are credited on the due date—provided sufficient funds are available in the borrower's bank account—this fee would generally not apply to EDA borrowers. The late fee Education is assessed for past due accounts covers additional work the direct loan servicer performs, such as sending second billing statements to borrowers, and making reminder phone calls. These collection activities occur at regularly scheduled intervals as part of Education's default prevention initiatives.

As previously stated, Education is assessed a fee for each day a borrower's account is at least 1 day past due. Education officials stated that this contract provision has been in place since FDLP implementation. In the past, the direct loan servicer sent late payment notices to borrowers as soon as payments were one day late. However, according to Education officials, borrowers who had already mailed their payments found these notices confusing. As a result, Education decided to delay late payment notification to allow additional time to receive those payments made by borrowers close to or on the due date. Presently, the direct loan servicer's first collection activity—sending a second billing statement—does not take place until a payment is 7 days late. However, Education is still assessed fees on payments that arrive 1 to 6 days late. In fiscal year 2001, Education paid $12.2 million or about $0.05 per day for each account that was at least 1 day past due. Because of limitations of data in the DLSS, Education is unable to determine the extent to which it is paying this fee each month for payments received between 1 and 6 days late.

Treasury Achieved Savings by Processing Loan Payments Electronically

In fiscal year 2001, we estimate Treasury, which has an interagency agreement with Education to process direct loan payments, saved about $1.2 million as a result of EDA. These savings are based on the dollar volume of payments received. Treasury estimates that processing payments electronically costs less than 1 percent of the cost of processing paper payments. For example, it costs about $16 to process $1 million through EDA; processing the same amount in paper payments costs about $1,897. According to officials from Treasury's Financial Management Service, Treasury processes payments for federal agencies to ensure efficient and timely processing of payments, and because Treasury can achieve economies of scale by providing this service throughout the federal government.

Conclusions

Regardless of the conclusions Education reached in its cost justification, borrowers who enroll in EDA will benefit from paying a reduced interest rate on their loans and the federal government will achieve administrative cost savings. Data limitations make it difficult to assess whether borrowers have changed their prepayment behavior as Education assumed in its cost justification, and thus, the extent of the benefit for both borrowers and the federal government is unknown. Even if data were available and showed borrowers' had changed their behavior, it would not tell us that this behavior changed as a result of entering EDA. Rather, borrowers could be making sound economic decisions such as choosing to prepay a higher rate loan rather then their federal student loan. By fully informing borrowers of the consequences of paying through EDA as well as their prepayment options, Education could ensure that borrowers have all the information they need to make sound economic choices. However, the limited disclosures Education currently makes to borrowers concerning their prepayment options under EDA are not sufficient to ensure that borrowers have all essential information to make informed decisions. Education does not make clear that, in spite of the 0.25 percentage-point interest rate reduction, borrowers might incur more interest cost over the life of their loans under EDA than they would if they continued to sometimes make payments in excess of the scheduled amount due.

Although Education did not include estimated administrative cost savings associated with EDA in conducting its cost justification, clearly, these savings would help offset the expense of offering borrowers a reduced interest rate. EDA can further reduce administrative costs associated with loan processing if more borrowers use it. Education has not promoted the benefits of EDA to borrowers as much as possible to maximize administrative cost savings to the federal government. Promoting the benefits of EDA to borrowers when they are considering their repayment options could achieve even greater administrative cost savings if more borrowers were to participate in EDA as a result. Moreover, EDAs should reduce the amount of higher fees that Education incurs for servicing past due accounts, because EDA payments are generally credited on time.

Although not related to EDA, Education may be able to achieve additional administrative cost savings. At present, Education is paying a fee for servicing EDA and non-EDA accounts that are at least 1 day past due. We believe that those fees may be unjustified because no action is taken to collect late payments until they are 7 days past due.

Recommendations

To help make the EDA program more useful and understandable to borrowers and take greater advantage of its potential savings to the taxpayer, we are making several recommendations to the secretary of education.

- To better publicize EDA and help Education achieve additional administrative cost savings, we recommend updating the *Exit Counseling Guide for Borrowers* to reflect the repayment incentives for direct loan borrowers who repay their loans through EDA as well as borrowers' prepayment options.
- To address concerns that borrowers may unknowingly pay more total interest over the life of their loans by not making prepayments if they make their loan payments through EDA, we recommend Education take steps to inform EDA borrowers about steps they can take to prepay their loans. Such steps could include modifying EDA applications to allow borrowers interested in prepaying their loans to designate withdrawal amounts in excess of their scheduled payments when they initially complete the EDA application.
- To ensure that the fees Education pays for servicing delinquent accounts appropriately reflect current collection activity practices, we recommend

Education consider renegotiating the fee provision in its contract with the direct loan servicer to eliminate the servicing fee for accounts with payments less than 7 days late.

Agency Comments

In comments we obtained, Education generally agreed with the information presented in the report. In response to our recommendation, Education said that it would explore updating the *Exit Counseling Guide for Borrowers* and explore taking other steps to better inform borrowers of their prepayment options. In addition, Education said it would consider renegotiating the direct loan servicing contract to move in the direction of paying for results rather than processes. Education also provided technical comments, which we incorporated where appropriate.

We are sending copies to the secretary of education, the secretary of the treasury, and the director of the Office of Management and Budget and will also make copies available to others on request. This report is also available on GAO's home page at http://www.gao.gov.

If you or your staff have any questions or wish to discuss this material further, please call me at (202) 512-8403 or Jeff Appel at (202) 512-9915. Other staff who made key contributions to this report include Barbara Alsip, Joel Marus, Scott McNabb, and Debra Prescott.

Cornelia M. Ashby

Cornelia M. Ashby
Director, Education, Workforce and
Income Security Issues

Appendix I: Comments from the Department of Education

UNITED STATES DEPARTMENT OF EDUCATION

THE DEPUTY SECRETARY

March 22, 2002

Ms. Cornelia M. Ashby
Director, Education, Workforce
and Income Security Issues
United States General Accounting Office
Washington, DC 20548

Dear Ms. Ashby:

Thank you for the opportunity to review and comment on your draft report, *Direct Student Loans: Additional Steps Would Increase Borrowers' Awareness of Electronic Debiting and Reduce Federal Administrative Costs.* We appreciate your providing members of Congress valuable information on the Federal Direct Student Loan Program (FDSLP). In the FDSLP, the Federal government provides loan capital and uses private contractors to perform loan origination and servicing functions.

The report acknowledges that FDSLP's electronic debiting initiative provides customer service and financial management benefits to borrowers and administrative savings to the American taxpayer. We are pleased that you recognize the successful aspects of our implementation of electronic debiting. We also appreciate your input on potential improvements in FDSLP electronic debiting, including your suggestions for improving the information we provide to borrowers. The Department is always looking for ways to improve disclosure to borrowers. To this end, we will look into updating the *Exit Counseling Guide for Borrowers* and taking other steps to provide borrowers with additional information on options for prepaying their student loans. As your report notes, last year we implemented an "On-line Advisor" feature which "pushes" information, such as prepayment options, to borrowers. In addition, we have recently learned that OMB has approved improvements to the Electronic Debit Account Brochure/Application. These changes inform the potential EDA enrollee of the availability of prepayment options. We are continuing to consider additional enhancements to our web-based and printed materials for both borrowers and institutions to provide increased disclosure about prepayment.

The Congress, the Department and the higher education community have long believed that the ability to offer student and parent borrowers a variety of repayment plans has long-term positive effects on student loan repayment. In addition to loan entrance and exit counseling provided by the schools, FDSLP conducts additional counseling during the grace period of the loan during which it educates borrowers about the various repayment options. This grace counseling helps ensure that borrowers are in a position to make an informed choice about the various types of FDSLP repayment plans available.

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

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We are pleased that you have noted the administrative cost savings generated through the electronic debit initiative. Some savings, such as those derived from Treasury's processing payments electronically rather than via paper payments and Education's reductions in paper bills, envelopes and postage costs, are relatively easy to measure. Other savings, such as those derived from reductions in delinquency and defaults, will take much longer to evaluate. We will be happy to share additional data as it becomes available. Finally, in response to the suggestion in your report, we will consider renegotiating the loan servicing contract to move in the direction of paying for results rather than processes.

We have attached an Appendix with technical comments.

Again, we appreciate the opportunity to comment on the draft report.

Sincerely,

William D. Hansen

cc: Sally Stroup
Greg Woods

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