FEDERAL STUDENT LOANS: Actions Needed to Improve Oversight of Schools' Default Rates (GAO-18-163)

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Overview

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Introduction

- The report addresses two main issues:

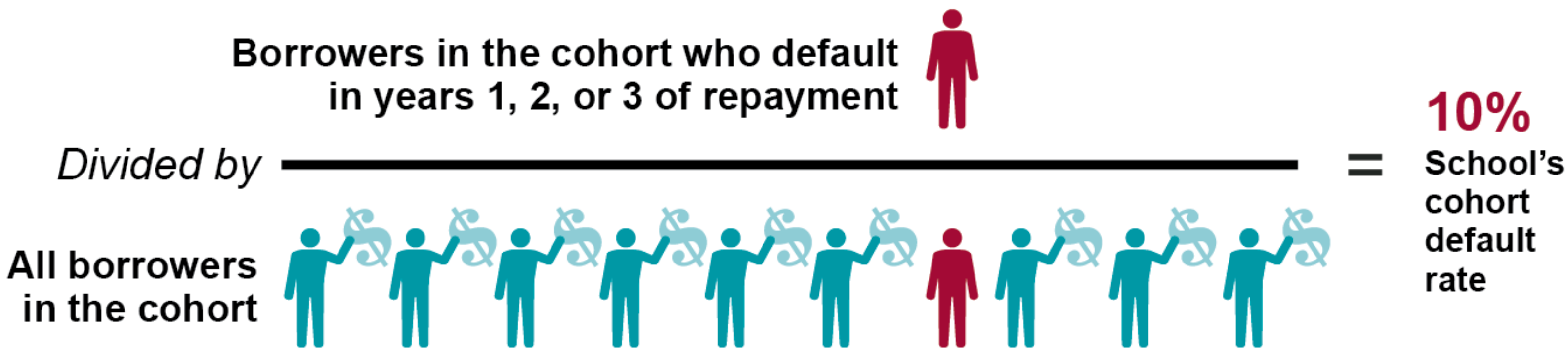
  (1) How schools work with borrowers to manage schools' cohort default rates (CDRs), and how these strategies affect borrowers and schools' accountability for defaults, and

  (2) The extent to which the Dept. of Education (Education) oversees the strategies schools and their default management consultants use to manage schools' CDRs and informs the public about its efforts to hold schools accountable

Background

- The CDR is the percentage of borrowers who enter repayment in a particular fiscal year who then default within 3 years.
- If a school has a CDR of 30 percent or greater for 3 consecutive years, or if it has a CDR above 40 percent for 1 year, it can lose access to federal student aid programs.

Example of School Cohort Default Rate Calculation



Source: GAO analysis of U.S. Department of Education information. | GAO-18-163

Background

- Education offers a variety of repayment plan options to borrowers, including Standard, Graduated, Extended, and Income-Driven Repayment plans.
- In addition, eligible borrowers may also temporarily postpone loan payments through deferment or forbearance.
- Under deferment, interest generally does not accrue on subsidized loans; in forbearance, interest generally does accrue.

Methodology: Schools' Default Management Strategies

For this report, we:

- Examined the practices of 9 default management consultants that served over 1,300 schools, which accounted for over 1.5 million borrowers in the 2013 CDR cohort
- Analyzed school-level data for the 2009-2013 CDR periods from:
  - Education's National Student Loan Data System (NSLDS)
  - Official CDR data published by Education
  - 3-year repayment rates from Education's College Scorecard
- Compared the effect that postponing student loan payments has on the CDR by calculating an alternative metric

Methodology: Education's Oversight

- Reviewed federal laws, including the Higher Education Act of 1965, as amended, and federal regulations
- Reviewed Education's internal guidance and documentation on calculating, assessing, and overseeing CDRs
- Interviewed Education officials responsible for overseeing federal student aid, including the CDR and default management consultants

Schools' Default Management Strategies

- Among the 9 consultants we selected, we found some examples when repayment and postponement options were presented to borrowers neutrally or forbearance was presented as a last resort.
- However, we also identified examples from 5 consultants when forbearance was encouraged over other options that may be more beneficial to borrowers, such as Income-Driven Repayment, Extended, or Graduated plans.
- These 5 consultants served over 800 schools, which accounted for over 875,000 borrowers in the 2013 CDR cohort.

Schools' Default Management Strategies

Some examples of forbearance being encouraged:

- 4 consultants sent past-due borrowers emails and letters that included only a forbearance application and instructed borrowers to return the application to them instead of their loan servicer.
- 1 consultant inaccurately stated in its letters to borrowers that the federal government can take away Supplemental Nutrition Assistance Program (SNAP) and Supplemental Security Income (SSI) benefits if they default.
- 1 consultant previously offered borrowers gift cards as an incentive to put their loans in forbearance.

Financial Incentives

- Schools and consultants have a financial interest in preventing borrowers from defaulting during the 3-year CDR period—8 of 9 consultants we selected were only paid by schools to contact borrowers within the CDR period.
- 4 consultants were paid by schools based on the number of borrowers they brought current on their loans during the CDR period, and representatives' salaries or incentives at 2 of these consultants were calculated based on this as well.

Incentives for Forbearance

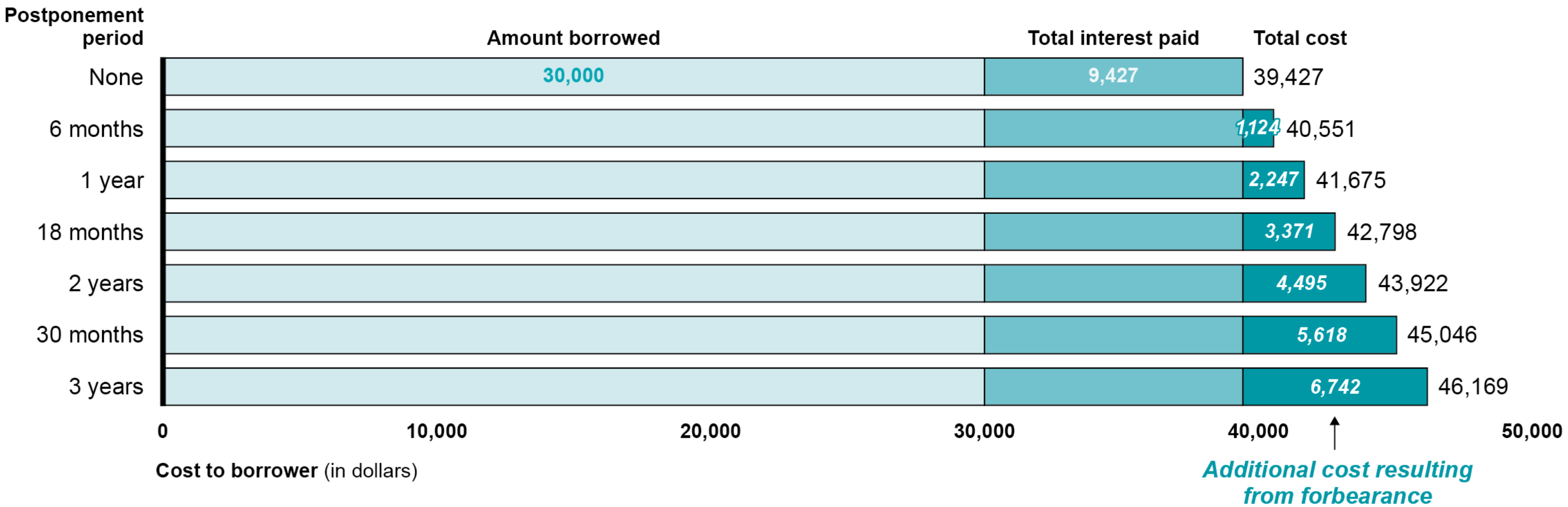
Some consultants have an incentive to encourage forbearance in particular as a strategy to prevent borrowers from defaulting within the 3-year CDR period in an effort to lower their client schools' CDRs. This is because:

- forbearance automatically brings past-due loans current.
- forbearance applications can be processed more quickly than other repayment or postponement options.
- loan servicers can grant general forbearance over the phone because there are no documentation requirements, whereas borrowers seeking deferment or Income-Driven Repayment plans must generally submit a written application.

Forbearance's Effect on Borrowers' Loan Costs

A typical borrower with $30,000 in loans who spends the first 3 years of repayment in forbearance would pay an additional $6,742 in interest, a 17 percent increase over spending no time in forbearance.

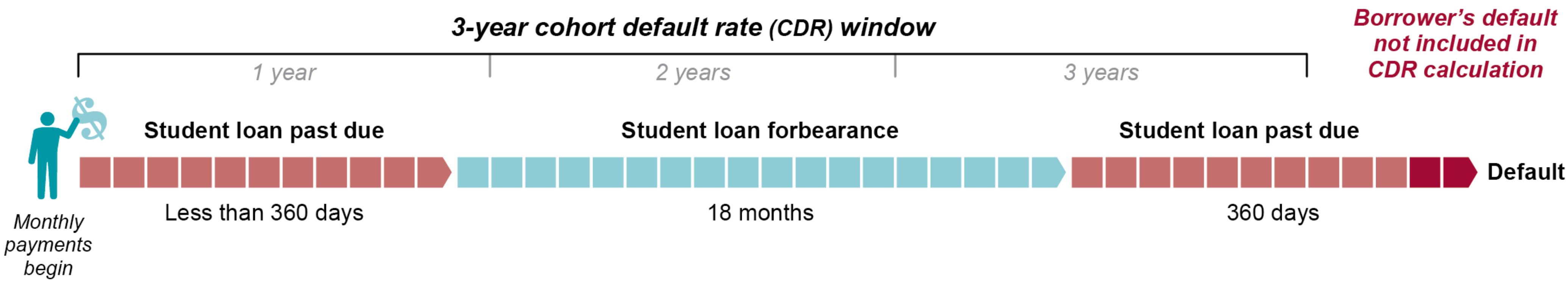
Example loan: ■ **Amount borrowed:** $30,000 ■ **Interest rate:** 5.7% ■ **Loan term:** 10 years (120 months)



Source: GAO analysis of U.S. Department of Education data. | GAO-18-163

Long-term Forbearance's Effect on the CDR

Example of How Long-Term Forbearance Can Reduce the Potential for a Borrower to Default within the CDR Period

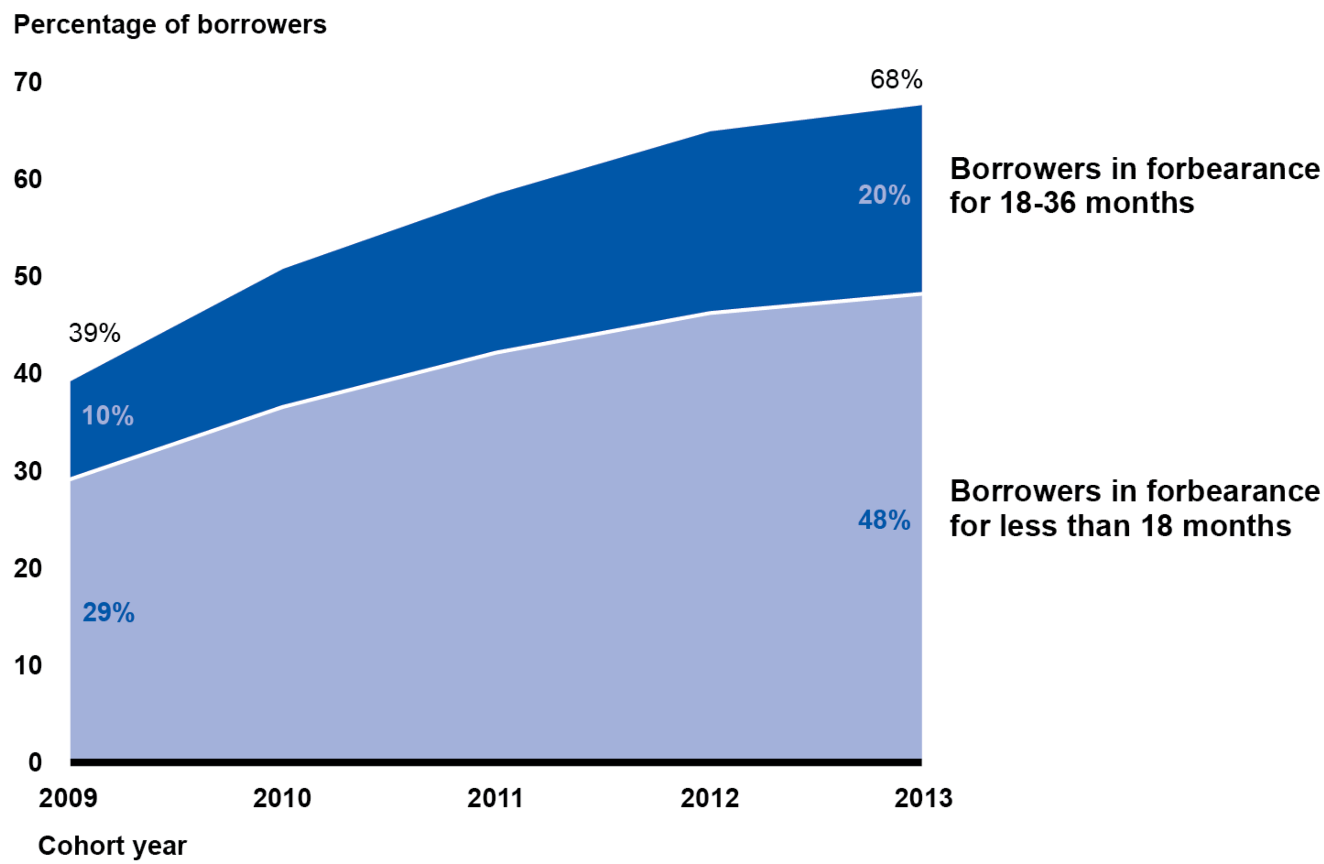


Source: GAO analysis of U.S. Department of Education regulations. | GAO-18-163

According to our analysis of Education's NSLDS data for the 2013 CDR period:

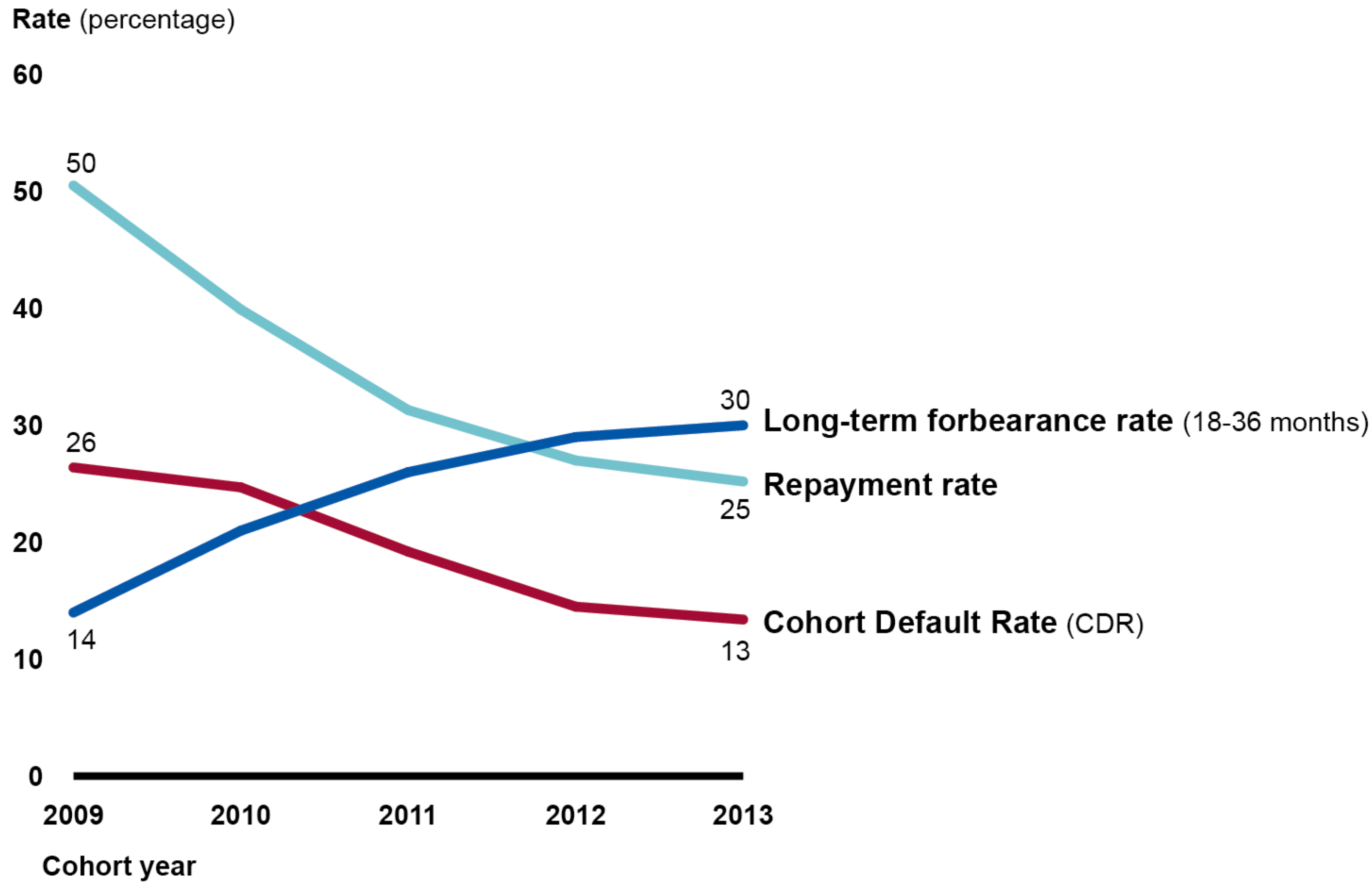
- Of borrowers not in forbearance: **20.3 percent** defaulted within the period
- In forbearance 0-18 months: **8.7 percent** defaulted within the period
- In forbearance 18-36 months: **1.7 percent** defaulted within the period

Borrowers in Forbearance during the First 3 Years of Repayment, 2009 to 2013 Cohorts



Source: GAO analyses of U.S. Department of Education data. | GAO-18-163

Selected Borrower Outcomes for Schools with CDR Decreases of 10+ Percentage Points, 2009-2013 Cohorts



Source: GAO analysis of U.S. Department of Education data. | GAO-18-163

Long-term Forbearance's Effect on the CDR

We examined the impact that removing borrowers in long-term forbearance from the CDR calculation would have on schools' reported CDRs:

- For the 2013 cohort, **35 schools** from our population had CDRs of 30 percent or higher.
- When we excluded from our population borrowers who spent 18 months or more in forbearance and did not default within the 2013 CDR period, we found **265 additional schools** that would potentially have had a CDR of 30 percent or higher.
- Of these 265 schools, 261 received a combined $2.7 billion in Direct Loans and Pell Grants in academic year 2016-2017.

Education's Oversight

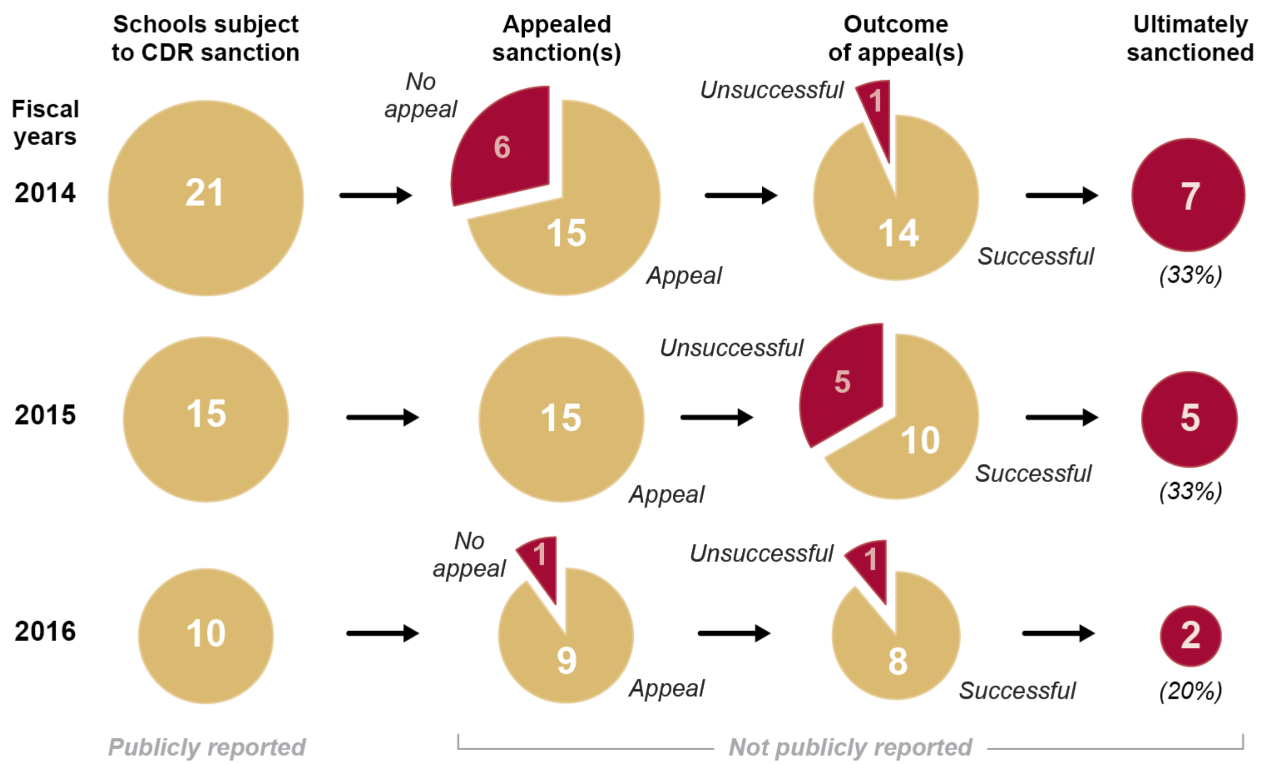
- Education's ability to oversee the strategies that schools and their consultants use to manage CDRs is limited because there are no requirements governing the interactions that schools and their consultants have with borrowers once they leave school.
- Education officials stated that the Department does not have explicit statutory authority to require that the information schools or their consultants provide to borrowers after they leave school regarding loan repayment and postponement be accurate and complete.

Education's Oversight

- Education reports limited information to the public about schools that face sanctions for high CDRs.
- The limited information overstates the extent to which schools are held accountable for their CDRs.
- Specifically, Education does not report the number of schools that successfully appealed CDR sanctions or the number of schools ultimately sanctioned.

Schools Subject to Education CDR Sanction and Appeals Outcomes, Fiscal Years 2014-2016

For the 2013 CDRs released in 2016, 10 schools were subject to sanctions, but only 2 schools were ultimately sanctioned.



Source: U.S. Department of Education data. | GAO-18-163

GAO's Recommendations

Congress should consider:

- strengthening schools' accountability for student loan defaults, for example, by (1) revising the CDR calculation to account for the effect of borrowers spending long periods of time in forbearance during the CDR period, (2) specifying additional accountability measures to complement the CDR, for example, a repayment rate, or (3) replacing the CDR with a different accountability measure.

- requiring that schools and default management consultants that choose to contact borrowers about their federal student loan repayment and postponement options after they leave school present them with accurate and complete information.

GAO's Recommendations

Education should:

- increase the transparency of the data it publicly reports on school sanctions by adding information on the number of schools that are annually sanctioned and the frequency and success rate of appeals.

GAO Report and Contacts

- For more information, see *FEDERAL STUDENT LOANS: Action Needed to Improve Oversight of Schools' Default Rates,* GAO-18-163 (Washington, D.C.: April 2018) at https://www.gao.gov/products/GAO-18-163

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- Questions?

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