DOCUMENT RESUME

ED 161 324	HE 010 535
TITLE	Status of Office of Education's National Direct Student Loan Funds at Selected Postsecondary Education Institutions. Report by the Comptroller General of the United States.
INSTITUTION	General Accounting Office, Washington, D.C. Div. of Human Resources.
REPORT NO	B-164031(1); HRD-78-94
PUB DATE	2 May 78
NOTE	57p.
AVAILABLE FROM	U.S. General Accounting Office, Washington, D.C. 20548
EDRS PRICE	MF-$0.83 HC-$3.50 Plus Postage.
DESCRIPTORS	College Administration; College Students; Educational Finance; *Federal Aid; Federal Programs; *Financial Support; Higher Education; *Loan Repayment; *School Funds; Student Financial Aid; *Student Loan Programs
IDENTIFIERS	Compliance; *National Direct Student Loan Program; Office of Education

ABSTRACT

The status of the U.S. Office of Education-sponsored National Direct Student Loan funds at 19 selected postsecondary schools was reviewed. Enabling legislation intended that schools attain a revolving fund status but each school differs in its ability to do this because different loan collection procedures are used. Legislation requires schools to make loans to nearly all eligible students and privacy considerations affect the extent that schools can pursue delinquent borrowers. Direct loan recipients display different payback characteristics depending on the type of institution they attend. This factor could account for part of the difference in the ability of institutions to attain a self-sustaining revolving fund status. The type of school is a major factor related to delinquency rates. Two-year public and proprietary institutions appear to have the greatest problem. It is unlikely that the majority of schools participating in the program will achieve a self-sustaining revolving fund status anytime soon. Management practices at participating institutions are discussed and it is concluded that most schools complied with due diligence requirements. Borrower profiles were developed based on a study of demographic, financial, academic, and direct loan status factors. Borrower characteristics most and least associated with delinquency are outlined. (SW)

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REPORT BY THE
Comptroller
OF THE UNITED STATES

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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-164031(1)

The Honorable Edmund S. Muskie
Chairman, Committee on the Budget
United States Senate

Dear Mr. Chairman:

This report contains information and our observations on the status of National Direct Student Loan funds at selected institutions. The National Direct Student Loan Program is administered by the Office of Education of the Department of Health, Education, and Welfare. We examined student and institutional characteristics and management practices at selected 2-year public and private nonprofit, 4-year public and private nonprofit, and proprietary institutions. The report discusses various factors that affect the ability of these institutions to attain a self-sustaining revolving fund status.

Due to the additional time required to obtain written agency comments, you requested that we not obtain them. However, the contents of this report were discussed with Department of Health, Education, and Welfare officials.

As requested by your office, we will send copies of this report to interested parties and make copies available to others upon request.

Sincerely yours,

Elmer B. Staats

Comptroller General
of the United States

COMPTROLLER GENERAL'S
REPORT TO THE CHAIRMAN,
COMMITTEE ON THE BUDGET
UNITED STATES SENATE

STATUS OF OFFICE OF EDUCATION'S NATIONAL DIRECT STUDENT LOAN FUNDS AT SELECTED POSTSECONDARY INSTITUTIONS

DIGEST

Since the National Direct Student Loan Program began in 1958, the net cumulative Federal capital contribution has totaled over $3.6 billion. Fiscal year 1977 appropriations were $323.2 million. Enabling legislation intended that schools attain a revolving fund status, but each school differs in its ability to do this because:

--Postsecondary schools manage the program differently and vary in the degree of diligence with which they attempt collection of loan accounts. (See p. 9.)

--Loan delinquency problems differ depending upon the type of institution. (See pp. 16 to 18.)

--Direct Loan Program legislation requires schools to make loans to nearly all eligible students, regardless of their credit worthiness. (See Ch. 3.)

--Other legislation affects the extent to which schools can pursue delinquent borrowers. (See Ch. 3.)

At June 30, 1977, 14 of the 19 postsecondary schools GAO reviewed had cumulative delinquency rates of at least 18 percent. Of these, 8 had rates of 30 percent or higher. Individual rates for the 19 schools ranged from 5 to 78 percent. The overall rate for the 19 schools was 21 percent. The total principal outstanding on delinquent loans was $11.2 million. Of the $11.2 million, $5.1 million represented payments overdue longer than 120 days. (See p. 15.)

The type of school is a major factor related to delinquency rates--2-year public and proprietary institutions appear to have the greatest problem. (See p. 17.)

Only 5 of the 19 schools did not request Federal capital contributions for 1977-78. Because of the problems cited above, and because of diverse school and borrower characteristics, GAO believes most of the schools participating in the program will not achieve a self-sustaining revolving fund status anytime soon. (See pp. 9, 17, and 34.)

Existing program legislation requires schools to lend to nearly all eligible students and privacy considerations hamper their attempts to locate borrowers. These two "uncontrollables" from the schools' viewpoint raise two questions that might warrant consideration. (See p. 30.)

--Should efforts be made to lower delinquency rates through tightening eligibility requirements, thus eliminating high-risk borrowers from the program?

--Should privacy considerations, which hamper efforts to locate delinquent borrowers, be relaxed?

HEW officials generally agreed with the report's contents and suggested some additions to recognize, among other things, HEW's planned actions to improve program management, factors which might affect delinquency rates at schools, and conditions which would have to be present in order for schools to attain a self-sustaining revolving fund status. (See ch. 6.)

Contents

ABBREVIATIONS

GAO	General Accounting Office
HEW	Department of Health, Education, and Welfare
OE	Office of Education

GLOSSARY

Basic Educational Opportunity Grant Program	A program which provides financial assistance to eligible students. Basic grants are to be the foundation of student aid packages.
Cancellations	Forgiveness of loans made to borrowers who serve in Head Start; certain teaching capacities; or (under certain conditions) in the Armed Forces; or who die, become disabled, or declare bankruptcy.
College Work-Study Program	An aid program which provides part-time jobs for financially needy students.
Default	A term defined in the Education Amendments of 1976 as the nonpayment of loans for 120 days (for loans repayable in monthly installments) or 180 days (for loans repayable in less frequent installments).
Deferments	Postponement of repayment obligations for borrowers during the period they are at least half-time students, or in the Armed Forces, Peace Corps or VISTA service.
Delinquent account	An account for which a required payment has been missed for a period of more than 120 days regardless of the type of payment plan. OE will no longer use this term after July 1978.
Dependent students	Students who receive financial support from their parents.
Due Diligence	Various efforts which institutions participating in Office of Education loan programs must undertake in the collection of such loans.

Educational Testing Service	A nonprofit organization, founded in 1947, which is devoted to measurement and research in education.
Fiscal Operations Report	A comprehensive, annual report which the Office of Education requires schools participating in its programs to complete.
Grace period	The 9- to 12-month period during which borrowers do not have to make payment on loans and which commences when the borrower ceases to carry at least a half-time academic course load.
Guaranteed Student Loan Program	A program that provides students with loans (through the private sector) which are guaranteed by a State or nonprofit agency or insured by the Federal Government against default.
Independent students	Students who are either veterans or who, for the calendar year in which they receive aid or for the prior calendar year, (a) do not receive financial support of more than $600 from their parents, (b) do not reside with their parents for more than 2 consecutive weeks, and (c) have not been claimed as exemptions by their parents on Federal income tax returns.
Multivariate correlation analysis	An analysis of the interrelationship of several or more variables.
Past due accounts	An account for which a required payment has been missed for 120 days or less. OE will no longer use this term after July 1978.
Repayment schedule	A document specifying the total loan amount and the due dates and amounts of repayment installments.

Revolving fund	A fund established to finance a cycle of operations through amounts received by the fund.
Self-sustaining revolving fund status	The position which schools participating in the Direct Loan Program attain when the amount they collect in loan principal and interest is sufficient to finance new loans.
Skiptracing	Using various means, such as telephone books, income tax returns and other items in order to obtain the most recent addresses of delinquent borrowers.
Supplemental Educational Opportunity Grant Program	A program which provides financial aid to students of exceptional need who would otherwise be unable to continue their education.

CHAPTER 1

INTRODUCTION

In response to an October 3, 1977, request from the Chairman, Senate Committee on the Budget, we reviewed certain aspects of the National Direct Student Loan (Direct Loan) Program, administered by the Office of Education (OE), Department of Health, Education, and Welfare (HEW).

The Chairman specifically requested that we identify the status of program funds at a sample of institutions and examine factors that explain apparent differences in their ability to establish self-sustaining revolving funds, as was intended in the original legislation. The Chairman expressed particular interest in

--management practices characteristic of the institutions,

--the risk profile of borrowers, and

--the delinquency rate and effectiveness of institutional collection activities.

We identified factors that explain differences in the ability of a sample of 19 institutions to attain a self-sustaining revolving fund status. We also analyzed borrower risk profile information at 18 of the 19 institutions. Information on the scope of work, including sample selection, and data analysis methodology is included on pp. 35 and 36.

PROGRAM DESCRIPTION

The Direct Loan Program was established under title II of the National Defense Education Act of 1958, as amended. The Education Amendments of 1972 incorporated this title into part E, title IV, of the Higher Education Act of 1965, as amended (20 U.S.C. 1087aa-ff). In 1972 the name of the program was changed from the National Defense Student Loan Program to the National Direct Student Loan Program.

The program provides for the establishment of loan funds at postsecondary educational institutions, so they can make long-term, low-interest loans to qualified students who need financial assistance to pursue a course of study on at least a half-time basis. Federal funds are generally provided each year to participating institutions. The Federal share under the program is 90 percent with the institutions supplying the remaining 10 percent. The institutions are responsible for making and collecting the loans.

The program is one of four OE student financial aid programs for which financial aid officers at the institutions determine eligibility and/or the amount of aid. The others are the Basic Educational Opportunity Grant, the College Work-Study, and the Supplemental Educational Opportunity Grant Programs, all of which are authorized by the Higher Education Act of 1965, as amended.

Funds available for the Direct Loan Program for fiscal year 1977 were $323.2 million, $310.5 million of which was for new Federal capital contributions, with the remainder being for student loan cancellations and institutional loans (made by OE to an institution to enable that institution to make its share of the capital contribution). Since the program began, the net cumulative Federal capital contribution has totaled over $3.6 billion.

When the Direct Loan Program was established, it was intended to operate on a revolving fund concept; that is, loans would be made and, as loan repayments (principal and interest) were made by borrowers, new loans could be made. Each year participating institutions could apply for additional Federal capital contributions. The amounts needed would depend on the solvency of their funds from prior years' operations; that is, the extent to which amounts collected were sufficient to enable new loans to be made. Some institutions have achieved a self-sustaining revolving fund status, whereas others have not. Those schools in a self-sustaining revolving fund status have no further need for Federal capital contributions as long as their funds remain solvent or unless they want to expand the program.

Of the schools which have not achieved a self-sustaining revolving fund status, some have requested new Federal contributions but, because of high delinquency rates for their Direct Loan Program or other problems, are precluded from receiving new monies, and others have requested and continue to receive new contributions.

OE distinguishes among the three types of institutions as those

--voluntarily not requesting new Federal capital contributions 1/,

--involuntarily not receiving new monies, and

--continuing to receive new monies.

Of over 3,000 institutions participating in the Direct Loan program, 310 did not request a Federal capital contribution for the 1977-78 award period. Another 350 schools requested but did not receive new monies. The remaining schools requested and received funds.

In February 1978, the Secretary, HEW, stated that as of June 30, 1977, an estimated 700,000 students had defaulted on Direct Loan notes, involving about $600 million in uncollected funds. Because the program works on a revolving fund principle, each defaulted loan results in a dollar-for-dollar reduction in the amount of aid available.

In this report, in order to analyze the trend of schools' cumulative delinquency rates over the past few years, we used OE's former method for computing delinquency although we recommended that OE adopt a new method in a November 5, 1976, report (HRD-77-17) to the Secretary, HEW. Usually this new method results in higher rates. Therefore, the rates referred to in our analyses are conservative.

Few schools included in our review have achieved a self-sustaining revolving fund status. About one-third of the schools included in our review have participated in the program since it began. One school which has participated for nearly 20 years, and two schools

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1/Some of these institutions may be in this funding status for one or more years and then revert to requesting additional capital contributions.

which have participated for 10 years or less are in a self-sustaining revolving fund status. Appendix II provides the fund status for the schools included in our review.

In a separate review, we are examining how Direct Loan Program funds are disbursed and how the related cash balances are maintained at the participating universities, colleges, and trade schools, to determine if schools are requesting excessive funding and if HEW is prematurely disbursing such funds to schools. Excessive cash balances are contrary to stated HEW and Department of the Treasury policies and regulations concerning good cash management. Moreover, providing Federal funds from the U.S. Treasury earlier than necessary can force the Government into additional borrowing to finance its operations, thus increasing the public debt and increasing interest costs.

In February 1978, the Secretary, HEW, announced several efforts to address the problem of excess Federal cash which may be held in some participating institutions. They were to:

--Build a new requirement for a cash flow analysis into the upcoming revision of the HEW audit guide.

--Formally obligate institutions to withdraw from their account with the Government only those funds needed for loan operations during the next 30 days.

--Develop procedures for determining and "recapturing" excess amounts of Federal capital from the revolving funds of participating institutions in time to affect allocations for academic year 1979-80.

We plan to issue to the Congress a report discussing these and other improvements needed in cash management practices at the completion of the review.

CHAPTER 2

MANAGEMENT PRACTICES AT PARTICIPATING INSTITUTIONS

Each institution participating in the Direct Loan Program is responsible for awarding loans and administering the billing and collection activities. Generally, administration of the Direct Loan Program is performed by two separate offices of an institution--the financial aid office and the business office. The financial aid office is responsible for determining the eligibility of prospective students and for approving loans. Unlike most other Federal student aid programs, the Direct Loan Program requires commitment and involvement on the part of the institutions long after students have completed their studies. This is a result of the repayment requirements of the loans. Institutions usually assign responsibility for loan collection to the business office.

PROGRAM ADMINISTRATION

At most of the schools included in our review, the Direct Loan Program was administered jointly by the financial aid and business offices. Only five schools had a single office responsible for the program. We discussed with school officials how they administered the program and the number and type of staff who perform Direct Loan functions.

Availability of program guidance and OE contacts

Guidance provided by OE to aid institutions in administering the Direct Loan Program includes

--enabling legislation including amendments,

--program regulations,

--program manual (app. 17, issued in 1967), and

--1977-78 Student Financial Aid Handbook.

In addition, school officials told us they have received OE "dear colleague letters," a Student Loan Collection Procedures manual, and OE Regional News-Memoranda.

Of the 19 institutions we visited, 18 were able to locate copies of the laws, program regulations, and program manual. Estimates as to the extent of use of this information varied from "occasionally" to "often."

Institutions' contacts with OE regional offices ranged from "no contact" to weekly phone calls and memorandums. The most frequent responses were "frequent" and "occasional." The nature of these contacts was usually to seek technical assistance, program guidance, and clarification. Only one school expressed dissatisfaction with the assistance provided.

We found no correlation between the frequency of contacts with OE and use of the aforementioned program guidance and schools' delinquency rates (see p. 3 for method used). For example, an official at one school, having a delinquency rate of over 50 percent at June 30, 1977, estimated he used program guidance 50 times annually; whereas another official at a school having a 5 percent delinquency rate indicated occasional use of the guidance. Another official told us he used the guidance on a regular basis; this school's delinquency rate was 5 percent also. These answers were given in response to structured interview questions.

Similarly, schools having frequent contact with OE did not have the lowest delinquency rates. For instance, one school having a 9 percent delinquency rate had no contact with OE; whereas an official of another school with a 59 percent delinquency rate estimated four contacts per month.

Staffing

At the schools in our review a total of 73 professional, 6 paraprofessional, and 178 clerical staff were responsible for administering the program. The size of the school and its loan program seemed to bear a relationship to the number of staff members who administered the program. Some schools have only 2 or 3 staff members to manage the program; others employ 10 or more persons. A breakdown of the staffing in the financial aid and business offices is shown in the following table.

Office	No. of professionals	No. of paraprofessionals	No. of clerical	Total
Financial aid	44	4	70	118
Business	29	2	108	139
Total	73	6	178	257

Most of the persons administering the Direct Loan Program also work on other programs or perform other functions.

Staff working in the financial aid office usually work on the awarding of Direct Loans, conducting exit interviews when students leave school, and other day-to-day program operations.

Although most schools included in our review delegated the billing and routine collection of loans to billing agents, some schools' business office personnel performed the billing and collection functions. Other business office functions include

--ensuring that promissory notes are signed,

--maintaining files of promissory notes,

--disbursing and accounting for loan proceeds,

--monitoring accounting for and administration of program funds, and

--monitoring the services of billing and collection agencies when employed, including transmitting the accounts to the respective agency.

DUE DILIGENCE

HEW's November 1976 program regulations require participating institutions to exercise due diligence in the collection of Direct Loans. Due diligence efforts include

--fully disclosing to borrowers their rights and obligations when they sign the promissory notes,

--conducting an exit interview with borrowers and providing them a copy of the repayment schedule before they leave school,

--maintaining a written record of the exit interview including a signed copy of the repayment schedule,

--maintaining contact with borrowers after they leave school,

--establishing and maintaining regular billing and followup procedures during the period in which any outstanding loan balance remains unpaid,

--using a commercial skiptracing organization or performing the equivalent service with institutional personnel to locate borrowers, and

--engaging a collection agency or performing collection activities with school personnel or resorting to litigation in those cases in which a borrower fails to make loan payments.

Before 1976, HEW had not specified detailed requirements for due diligence.

Functions performed by billing agents include

--contacting borrowers during the grace period,

--billing borrowers,

--receiving payments and applying them to the respective accounts,

--answering borrowers' questions and preparing correspondence,

--processing deferment and cancellation forms, and

--providing various reports to the school.

The fee for these billing agents' services ranged from about 50 cents to nearly $1 per account monthly depending upon the frequency of billing. In addition, all schools used one or more agencies to collect past due and delinquent accounts. The success of these collection agents' efforts (for past due and delinquent accounts) has been limited. (See p. 11.)

Schools' due diligence efforts

Generally the schools we reviewed were complying with HEW's November 1976 requirements for due diligence. However, individual schools were lax in certain efforts.

Although all 19 schools had established procedures for conducting exit interviews with borrowers, one did not conduct these interviews. Most of the schools conduct individual as opposed to group interviews. Program regulations require individual interviews, when feasible. In most instances the interviews were held for graduating students and those who officially withdrew from school. For at least 13 schools, students who failed to attend the exit interview were mailed a copy of the interview form to be completed and returned to the school. Five schools did not mail the forms to students. We were unable to determine whether the other school mailed exit interview forms.

Seventeen schools routinely provided borrowers with copies of the promissory note, but only six schools required the borrower to acknowledge the receipt of the copy. Fourteen schools provided the borrowers with copies of the repayment schedule; however, only nine of the schools required the borrower to acknowledge receipt. Most schools do not use certified mail when communicating with the borrower.

Contacts with borrowers during the allowed 9- to 12-month grace period before beginning loan repayment ranged from none to five. One school contacted only those borrowers who failed to appear for an exit interview. There was no correlation between delinquency rates and the number of contacts during the grace period.

Some schools which used billing agents were less likely than those which did not to be aware of the number of contacts being made with borrowers. Some schools which used billing agents had no specific knowledge about the number of contacts made during the grace period. For instance, an official at one 2-year school "thought" the billing agent was making one contact. This school's cumulative delinquency rate at June 30, 1977, was 26 percent.

During our review, an aid officer at another 2-year institution contacted the school's billing agent to determine the number of contacts being made. The billing agent's representative initially responded that he believed three contacts were made but that he would have to check the regulations. This institution's cumulative delinquency rate at June 30, 1977, was 59 percent.

We noted that several schools did not turn over their accounts promptly to the billing agent. For example, one public college was cited by a State official for turning over accounts long after the billing should have begun. The official stated that some accounts were turned over at least 19 months after the grace period had expired. This school's cumulative delinquency rate at June 30, 1977, was 50 percent.

The loss of contact with borrowers during grace periods is a problem for schools. The schools in our review used various techniques to locate borrowers, including

--contacting other campus offices (alumni, financial aid, registrar's, and admissions),

--requesting address corrections from the post office,

--contacting parents, other relatives, friends, and neighbors,

--conducting address and telephone searches,

--using commercial skiptracing facilities, and

--putting a "hold" on requests for transcripts.

Officials at several schools told us that privacy legislation had hampered their attempts to locate borrowers. For example, schools can no longer use the Internal Revenue Service's skiptracing service--which is viewed as an effective tool. An official told us that the school can no longer use the State motor vehicle administration to trace borrowers via their drivers license or vehicle registration. Some officials expressed frustration at being charged with minimizing their delinquency rates while being precluded from using these previously proven methods. An Educational Testing Service study did not show that these were the most effective methods for locating delinquent borrowers. (See pp. 26 and 27.) HEW regulations state that schools should use commercial skiptracing services or perform the equivalent service with their own staff.

Although the 19 schools use collection agents for their past due and delinquent accounts, the success of the agents' efforts has been limited. For example, at June 30, 1977, on delinquent loans having cumulative principal outstanding of $11.2 million, $5.1 million was determined by the 19 schools to be the amount of payments which had been overdue longer than 120 days. Agents collected $317,950 during the 1976-77 award period [1] (or 6.2 percent). Seventeen schools paid collection agents $169,809 for their efforts. Two schools' agents made no collections. The fee for the service averaged about 53 percent of the amount collected. Even if no additional principal was determined to be delinquent and if about $318,000 (the approximate amount collected during the 1976-77 award period) were collected each year, it would take about 16 years to complete the task of collecting on these accounts.

Although HEW regulations provide that schools may resort to litigation, schools in our sample did not often use litigation. For example, during the 1976-77 award period, 4 of the 19 schools had accounts in litigation. Litigation was resorted to less in years prior to 1976-77. At least two schools have never attempted to collect past due or delinquent accounts in the courts. At another institution during a 21-month period ended May 31, 1977, a collection agency requested authority to sue 255 borrowers. The school approved litigation for six cases.

Statutes of limitations, which vary from State to State, can further complicate collection efforts. For

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[1] July 1, 1976-June 30, 1977

the nine States in which our sample schools were located, the statute of limitations ranged from 4 to 6 years with a 6-year limit in seven of the nine States. Once the statute of limitations expires, the opportunity to collect on accounts for which payments have been missed is lost.

CORRELATION BETWEEN MANAGEMENT PRACTICES AND DELINQUENCY

After examining the schools' Direct Loan management practices, we performed tests of significant difference to determine the relationship, if any, between the loan delinquency rates and each of the following:

--The schools' funding status (see p. 3).

--The availability of program guidance (see p. 5).

--The frequency of use of this guidance.

--The frequency of contacts with OE.

--The use of a commercial billing agent.

--Use of a collection agency.

--Whether the school performs verification of information submitted by aid applicants or their parents.

--Whether the school discusses with borrowers the nature and obligation of a Direct Loan when they sign the promissory notes.

--Whether the school provides truth-in-lending statements to borrowers when they sign the promissory notes.

--Whether the school conducts exit interviews.

--Whether the school provides students with copies of promissory notes (when they sign them) and repayment schedules (before they leave school).

--Whether the school requires borrowers to acknowledge receipt of copies of promissory notes and repayment schedules as part of the exit interview procedures.

--The number of contacts during the grace period.

--Whether the schools take delinquent borrowers to court.

Of these items, only one showed a significant relationship to delinquency rates. Those schools in our review having higher delinquency rates were more likely to use a commercial billing agent than schools which did their own billing. There are at least two possible explanations. Schools which were having problems with high delinquency may have elected to use a billing agent in order to (1) eliminate or alleviate the problem or (2) simply get rid of the responsibility for servicing the accounts.

We did not perform a multivariate correlation analysis to determine how a combination of the management practices relates to delinquency or whether borrower risk profile characteristics (see ch. 4) affect institutions' delinquency rates more than their management practices.

CONCLUSIONS

Schools included in the review were, for the most part, complying with HEW's November 1976 due diligence requirements. We did find isolated cases of noncompliance and discussed these with school officials. Schools vary in executing due diligence requirements, such as exit interviews, contacts during the grace period, and the use of litigation.

A correlation analysis of various management practices and delinquency rates identified only one clearcut relationship--the use of commercial billing agents is related to delinquency rates. Schools using billing agents tended to have higher delinquency rates --possibly because the situation had gotten out of hand before the accounts were sent to the agent.

Something which would not have shown up in our analysis but which could be a factor in the schools' abilities to achieve a revolving fund status is that

HEW's detailed requirements for due diligence were not promulgated until November 1976. Therefore, even those schools which are complying with these requirements may have a relatively brief history of due diligence efforts, and consequently, their delinquency rates may continue to be high for some time. These schools may require several years before they realize substantial recoveries as a result of their efforts, or they could realize very little, especially for older accounts.

In our opinion it is unlikely that many schools participating in the Direct Loan Program will achieve a self-sustaining revolving fund status anytime soon even if they adhere rigidly to HEW's relatively new due diligence requirements.

CHAPTER 3

PROBLEMS CAUSING CONTINUED

HIGH LOAN DELINQUENCY

We calculated the cumulative delinquency rates at June 30, 1977, for the schools we reviewed. The rates ranged from 5 to 78 percent. The overall rate was 21 percent. Of 14 schools which had delinquency rates of at least 18 percent, 8 had rates of 30 percent or higher. These high rates can result from a combination of controllable and uncontrollable factors. A controllable factor is the effectiveness of the schools' loan collection procedures. Among the uncontrollable factors are

--legislation which requires schools to lend to nearly all eligible--needy--students and which prohibits the use of cosigners on loans, and

--privacy considerations which may preclude schools from locating borrowers through such diverse means as drivers license and vehicle registration, or enhancing collections by providing information on delinquent accounts to credit bureaus.

School officials expressed frustration at being denied new capital contributions or having their requests for funds reduced because of excessive delinquency when they (1) have little control over who receives loans and (2) are hampered in their efforts to locate borrowers by restrictive legislation and regulations.

ANALYSIS OF DELINQUENCY AT SCHOOLS REVIEWED

The cumulative delinquency rates at June 30, 1977, for the 19 schools in our review ranged from 5 to 78 percent. (See app. II). Fourteen schools had a cumulative delinquency rate of 18 percent or higher; 8 had rates of 30 percent or higher. As of June 30, 1977, average delinquent amounts at the 19 schools ranged from $159 to $729 per borrower. As stated on page 11, on delinquent loans having cumulative principal outstanding, at June 30, 1977, of $11.2 million, schools reported that $5.1 million was the amount of payments which had been overdue longer than 120 days. The following table shows cumulative delinquency rates for the schools reviewed.

	As of June 30, 1977			As of June 30, 1976			As of June 30, 1975	
Delinquency rate in percent	Number of institutions reporting	Percent of total		Number of institutions reporting	Percent of total		Number of institutions reporting	Percent of total
0 - 10	5	26.3		4	21.0		5	26.3
11 - 30	7	36.8		5	26.3		5	26.3
31 - 60	6	31.6		9	47.4		8	42.1
Over 60	a/ 1	5.3	b/	1	5.3	c/	1	5.3
Total	19	100.0		19	100.0		19	100.0

a/78 percent

b/81 percent (same school as note a).

c/84 percent (same school as note a).

The table shows a short-term improvement toward lower delinquency rates; however, analysis over a longer period would provide a better measure of trends in the delinquency rates. Because information was not available we could not develop such trend data. Also, the above analysis shows the schools' cumulative delinquency rates, rather than annual rates so that changes in the schools' situations are less clear than they would be if the delinquency rates were expressed in annual terms. Therefore, we used a formula generated by the Educational Testing Service in its study of the Direct Loan Program (see p. 22) to calculate annual rates--the amounts past due 1 year or less expressed as a percentage of the collections for the year plus the amounts past due 1 year or less.

We analyzed annual rates for the 19 schools for the 12-month periods ended June 30, 1975, 1976 and 1977. The results of this analysis showed that the situation was improving at only seven schools. At these seven schools, the net decrease in the annual delinquency rates from 1975 to 1977 ranged from 14 to 63 percent. One school's rate did not change. The remaining 11 schools showed net increases (in their rates) ranging from 23 to 733 percent. 1/ Delinquency rates increased at three of the five 2-year public schools and at all three of the proprietary schools included in our review. For more details, see appendix III.

We ranked the 19 schools in order of annual delinquency rates from highest to lowest for each of the 3 years. Our analysis showed that the relative position of seven schools did not vary by more than three positions between any 2 years. Positions of the remaining 12 schools showed greater variation between any 2 years. We also noted that 7 of the 19 schools consistently had the highest delinquency rates during each of the 3 years. All but one of these seven schools were either 2-year public or proprietary schools.

Of the 19 schools in our review, 5 did not request new Federal capital contributions, 5 requested but were denied new monies, and the remaining 9 requested and received Federal capital contributions for the 1977-78 award period. The following table provides a breakdown, using OE's most recent delinquency rate categories, of the number of schools we reviewed which fell in each category as of June 30, 1977.

Delinquency rate	Did not request funds	Were denied funds	Requested and received funds
0 - 10	2	-	3
11 - 30	1	2	4
31 - 60	1	3	2
Over 60	a/ 1	-	-
Total	5	5	9

a/78 percent

1/The school with a 733 percent increase was a 2-year private nonprofit institution which experienced an increase in its annual delinquency rate from 3 to 25 percent. Although the percentage increase is high, this does not mean that the school had the worst delinquency problem. For instance, a proprietary school's rate increased

In December 1977, OE estimated the delinquency rate for all participating schools at 12 percent and the rate for 2-year public institutions at 31 percent--the highest among the various types of schools. Our analysis of delinquency rates for the 19 schools reviewed showed that when ranked from the highest to the lowest, 2-year public and proprietary schools have the highest cumulative delinquency rates. For example, at June 30, 1977, 6 of the 10 schools having the highest cumulative delinquency rates were 2-year public and proprietary schools. Appendix II lists schools by type and their cumulative delinquency rates at June 30, 1977.

The results of our analysis appear to be similar to those reported by the staff of the Board of Governors of California Community Colleges for California schools in a September 1977 report to the Board of Governors. The report stated that the delinquency rate among California community colleges was more than 40 percent--or four times the rate of either the University of California or the State University and Colleges. The report mentioned several factors which contributed to the unusually high delinquency rate.

> "First, and the major contribution to this problem, is that in past years institutions were not only urged by the Office of Education to use loan funds but were prohibited from discriminating for any reason regarding the award of loans to students. Thus, for a student who had an unmet financial need and who may have been a poor loan risk, the aid officer had no legal means of denying that student loan funds if the money was available. Research documents that Community Colleges traditionally enroll the majority of the low income/disadvantaged students who may be in the higher loan risk category. However, high delinquency rates have been not only the result of restrictive O.E. guidelines but of poor collection efforts by the institutions. Other than lack of adequate staffing, a factor added to the collection problems, is the mobility of Community College students and the lack

> of knowledge of aid offices regarding their students' future enrollment status. Aid officers claim that with insufficient financial aid staff, both in the business and financial aid offices, they are unable to properly differentiate between those students who drop-out from those who transfer to another institution. Because of the lack of sophisticated methods to determine the enrollment status of these students, they are simply reported as 'delinquent.' In a high majority of cases, Community College students transfer and do not inform the aid office of their new enrollment status and/or their new or forwarding address. As a result, this student is recorded as 'delinquent' at the previous institution."

The report encouraged institutions to undertake a cost/benefit analysis to determine if continued participation in the program was advantageous to the institution and its students.

Officials at the schools in our review cited some of the following reasons for high delinquency rates.

--Statutory language does not emphasize credit management processes such as preloan credit checks, and legislation precludes schools from requiring cosigners or from denying loans to certain students who are considered poor credit risks.

--Students are transitory.

--The Internal Revenue Service's skiptracing service cannot be used. 1/

--Strong collection efforts, until recent years, were not used.

1/H.R. 6715, 95th Congress, which would restore OE's authority to use this service, was passed by the House of Representatives on October 17, 1977. On February 3, 1978, the bill was ordered to be reported out of the Senate Committee on Finance.

--Technical assistance has not been provided by anyone, including OE, to help establish credit management procedures.

--Students have not filed deferment forms and reported address changes.

--Students do not understand the repayment obligation, despite the fact that they sign promissory notes and attend exit interviews.

CORRELATION BETWEEN OTHER FACTORS AND DELINQUENCY

In addition to analyzing management practices and delinquency (see ch. 2), we examined other factors' relationship to delinquency. For example, among the factors were

--type of institution;

--percentage of Direct Loan recipients to total enrollment;

--percentage of total aid recipients to total enrollment;

--percentage of Direct Loan recipients to total aid recipients;

--the average delinquent amount per delinquent borrower;

--the average Direct Loan amount; and

--the year in which the school first participated in the program.

Of the seven items examined, three showed a significant relationship to delinquency: (1) the type of institution, (2) the percentage of Direct Loan recipients to total aid recipients, and (3) the year in which the school first participated in the program. Of the 19 schools reviewed, the 5 having the highest cumulative delinquency rates were four 2-year public schools and one proprietary institution.

The cumulative delinquency rates for the seven schools which have been in the Direct Loan Program since it began ranged from 5 to 30 percent (4 of the 7 had rates of 10 percent or less). The rates for nine schools which entered the program in 1966 or later ranged from 7 to 78 percent (5 of the 9 had rates of more than 30 percent). One explanation is that all schools which have been in the program since it started are 4-year institutions, which have already been shown to have lower delinquency rates. Also, many community colleges did not enter the program until the mid-1960s or later, and these schools typically have higher delinquency rates.

An inverse relationship existed between delinquency and the proportion of Direct Loan recipients to total aid recipients. That is, the lower a school's ratio of Direct Loan recipients to total aid recipients, the higher its delinquency rate tended to be.

Two other factors showed some (but not a significant) relationship to delinquency rates:

--The ratio of Direct Loan recipients to total enrollment.

--The average loan amount.

An inverse relationship was indicated between delinquency and the number of Direct Loan recipients compared to total enrollment. Thus, higher delinquency rates are found among schools having a low ratio of Direct Loan recipients to total enrollment. A possible reason is that such schools have a relatively low investment in the program and may therefore lack the necessary concern regarding delinquent accounts.

Lower delinquency rates were more common among schools having a higher average loan amount. The type of institution may explain this situation because most schools having the higher average loans per student were 4-year institutions which typically have lower delinquency rates.

EDUCATIONAL TESTING SERVICE STUDY RESULTS

In May 1970, the Educational Testing Service submitted a proposal to and subsequently contracted with OE to perform a study of the National Defense Student Loan Program. The organization proposed a comprehensive study to

--determine whether the legislative intent had been met,

--study the management effectiveness and the program's impact, and

--make specific recommendations for improving the form and administration of the program.

The organization (1) mailed questionnaires to loan officials (financial aid and fiscal) at <u>all</u> participating institutions, (2) interviewed officials at 35 institutions, (3) interviewed 10 to 20 borrowers at each of the 35 schools, and (4) analyzed data obtained from schools' applications for funds and expenditure reports.

Although the organization did not send OE a final report on the study results because of involvement in other work it sent some preliminary results to OE in July 1974. The analyses included: the relationship between institutions' administrative practices and their delinquency rates, institution billing procedures, institution deferment and cancellation procedures, use of commercial billing and collection services, procedures for pursuing delinquent borrowers, delinquency rates, and maintaining contacts during the grace period. In its analysis, the Educational Testing Service used annual delinquency rates rather than cumulative rates because the firm felt annual rates would be more responsive to the schools' administrative practices in a given year. A discussion of the firm's findings follows.

Exit interviews

The study showed that schools having lower delinquency rates were more likely to conduct exit interviews with nearly all graduating borrowers and vice versa. The study reported that many schools have difficulty arranging exit interviews with students who terminate before graduating because these students generally leave with little or no advance notice. There was also a significant relationship between conducting exit interviews with dropouts and delinquency rates.

There was no significant relationship between delinquency rates and schools' methods for conducting interviews (i.e., individual versus group sessions). The finding suggests that the method of conducting the interview is not nearly as important as the actual conduct of the interview.

School officials were asked whether, during the exit interview, the schedule of repayment was discussed and whether they felt borrowers gained a thorough understanding of their repayment obligations. Analysis of responses indicated that schools with lower delinquency rates were more likely to discuss the repayment schedule during the interview. There was a significant relationship between delinquency rates and the perceived borrowers' understanding, after the interview, of their repayment obligations.

The study also revealed that schools with lower delinquency rates were somewhat more likely to obtain the address of the borrower's parents and vice versa. However there were no clearcut relationships between delinquency rates and the obtaining, during the exit interview, of

--the borrower's address for the first billing,

--the address of references,

--the address of the borrower's bank,

--the address of the borrower's church, or

--the address of the borrower's present employer.

<u>Cancellations and deferments</u>

The study queried institutions on their administrative arrangements regarding cancellation and deferment forms. Only 15 percent of the schools which responded sent these forms to all borrowers. About 40 percent of the schools sent the forms to only those borrowers who requested them. Two-year schools (both public and private) were more likely than other types of schools to expect borrowers to request the forms.

The study asked fiscal officials to identify problem areas in administering the loan program by indicating the degree of difficulty experienced with several aspects of the program, including determining borrowers' eligibility for cancellations and deferments; determining amounts to be cancelled and others. The majority of schools (about 70 percent) had little or no difficulty determining eligibility for cancellations. A similar situation existed for determining deferment eligibility with 73 percent of the schools expressing little or no difficulty. Of the various types of schools, 4-year schools had the least difficulty in their eligibility determinations for both cancellations and deferments.

About two-thirds of the schools responding had little or no difficulty determining amounts to be canceled. However, schools apparently had more difficulty in maintaining records to allow postponement of installments in anticipation of cancellations. About 23 percent of the schools had some or considerable difficulty in this area, with 4-year public institutions having somewhat more difficulty than other types of schools.

One of the biggest problems for schools is timely submission by borrowers of their cancellation and deferment forms. For example, the study showed that over 55 percent had some or considerable difficulty in obtaining timely submission of cancellation forms and 62 percent had similar problems with deferment forms. Four-year public schools experienced more difficulty than other types of schools.

Use of commercial billing and collection services

More than one-third of the schools included in the Educational Testing Service's study used a commercial billing service. Although the Testing Service did not define "hard-core" delinquent accounts, it did distinguish between all and hard-core delinquent accounts. The study showed that about 25 percent of the schools used an outside collection agency for all delinquent accounts, whereas 40 percent of the schools used a collection agency for hard-core accounts. The study revealed that private institutions were more likely to use a billing service, whereas public schools made more use of collection agencies.

Other due diligence efforts

There are numerous procedures schools may employ as well as administrative sanctions they may take with respect to borrowers in repayment status. For example, the study queried school officials about the number of times delinquent borrowers are reminded of their obligations before legal action is considered. The majority (53 percent) of the schools indicated a frequency of five or more times.

Among the sanctions used by schools included in the study were

--23 percent assessed penalty charges for loans not paid when due,

--64 percent prohibited release of grade transcripts for delinquent borrowers,

--83 percent sent letters threatening legal action to delinquent borrowers,

--68 percent turned delinquent accounts over to a lawyer or a collection agency, and

--26 percent charged the borrower for collection costs.

The Educational Testing Service study queried fiscal officers about the degree of difficulty of several administrative functions such as complying with truth-in-lending legislation, preparing OE's fiscal operations reports (the end-of-year expenditures report), retaining professional and clerical staff for loan billing and collections, and locating delinquent borrowers. Of the above functions, schools had the greatest difficulty locating delinquent borrowers. About 80 percent indicated some or considerable difficulty performing this task.

About 90 percent of the 4-year public institutions had difficulty locating borrowers, and 60 percent of the 2-year private schools identified locating borrowers as a somewhat or considerable problem.

Over 50 percent of the schools expressed some or considerable difficulty maintaining contact with borrowers between the time they leave school and when their first payment is due, and preparing OE's fiscal operations reports. Public institutions appeared to have more problems in these areas than did the private institutions.

Retention of professional and clerical staff responsible for loan billing and collections did not seem to be a major problem for schools included in the study. Over 50 percent stated that they had little or no difficulty retaining staff to perform these functions. About 25 percent stated the question did not apply to them. The Educational Testing Service concluded that most of the schools in this category probably used commercial billing services.

OE has determined that truth-in-lending requirements apply to lenders participating in the Direct Loan Program. Fiscal officers were asked the extent of difficulty in complying with these requirements. Nearly 80 percent responded with "little or no difficulty." About 13 percent of public universities and 12 percent of 4-year private schools indicated some or considerable difficulty.

The study also requested officials to assess the effectiveness of several techniques for locating delinquent borrowers, including the Federal skiptracing service; parents or guardians; alumni offices; college placement officers; drivers license agencies; armed forces; merchants' retail credit associations; and schools to which grade transcripts have been sent.

Fiscal officers reported that the most effective method for locating delinquent borrowers was contacting their parents. Seventy-two percent stated that such contact was fairly or very effective. The next most effective way was contacting the alumni office (38 percent), followed by contacts with schools to which transcripts had been sent (31 percent). Armed

Forces (25 percent); Federal skiptracing service (22 percent); and drivers license agencies (10 percent).

The study compared various administrative practices with schools' delinquency rates, revealing that

--schools with the lowest delinquency rates were more likely to routinely send teacher cancellation request forms (OE requires borrowers who teach to file these forms each year as a prerequisite to canceling a portion of the Direct Loans) only to borrowers who taught the preceding year. Conversely schools which sent the forms to all borrowers and those which sent forms only upon the borrowers' requests tended to have higher delinquency rates,

--schools which took the initiative and sent request for deferment forms to borrowers rather than waiting for students to request the forms, were more likely to have lower delinquency rates,

--schools with lower delinquency rates were more likely to prepare bills manually than by computer,

--schools with higher delinquency rates were more likely to use a commercial billing service,

--there was no significant relationship between the frequency of billing and the delinquency rate 1/ or between assessment of penalty charges and delinquency rates,

--schools with lower delinquency rates were more likely to send five or more reminders to delinquent borrowers,

--schools with lower delinquency rates were more likely to prohibit release of grade transcripts for delinquent borrowers,

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1/However, schools with the best collection record were more likely to send quarterly bills.

--there was no significant relationship between delinquency rates and whether schools sent letters threatening legal action to delinquent borrowers,

--although not a significant difference, a somewhat higher percentage (76 versus 70) of schools with lower delinquency rates than schools with higher delinquency rates turned accounts over to a lawyer or collection agency,

--charging delinquent borrowers for collection costs appeared to bear little relationship to a school's delinquency rate, and

--there was no significant relationship between permitting partial payments and a school's delinquency rate.

The study's overall conclusion was that a higher delinquency rate was associated with being a 2-year institution, using a billing service, being a public institution, and billing on a monthly or bimonthly basis. Lower rates were associated with having exit interviews with students who drop out of school, turning delinquent accounts over to a lawyer or collection agency, discussing the repayment schedule during the exit interview, being a university, and conducting exit interviews with graduating borrowers.

EFFORTS TO IMPROVE PROGRAM MANAGEMENT

HEW officials told us they are planning program reviews at about 2,000 participating institutions. HEW has identified 18 factors that can serve as indicators of problems in administering and managing student assistance programs. A key factor is the Direct Loan default rate. Only institutions with a high rate were included on the list of schools scheduled for program reviews. The reviews are tentatively scheduled for April-September of 1978.

CONCLUSIONS

In our analysis of various factors, such as total enrollment, the number of aid recipients, and loan amounts, we found that the type of institution is a primary factor related to delinquency rates--2-year public and proprietary institutions appear to have the greatest problems with delinquency. These points are supported by other studies. The year in which the school first entered the program and the proportion of Direct Loan to total aid recipients also bear a significant relationship to delinquency. In general, schools which have been in the program since it started have a low ratio of Direct Loan to total aid recipients and are 4-year institutions which tend to have lower delinquency rates.

Problems with delinquency result from a combination of controllable and uncontrollable factors. Schools should be able to alleviate their delinquency rates with effective collection procedures--including using litigation and devoting adequate staff to monitor the status of loan recipients and efforts of collection agencies. However, they have little control over certain aspects of the program because:

--program legislation requires schools to lend to nearly all eligible (needy) students, and

--privacy considerations hamper schools' efforts to locate borrowers.

We noted that five of the schools in our review having delinquency rates of over 30 percent either did not request new Federal capital contributions or were denied them by OE; however, two others did receive new funds.

A possible sanction HEW could use is to deny new funds to schools if their delinquency rates exceed a certain maximum percentage. However, a problem in using this sanction is that the delinquency rate may reflect (1) bad management practices in years past which have subsequently been improved, (2) a school which has a high proportion of high risk borrowers, and (3) other corrected or seemingly valid reasons. In order to decide which schools' rates are due to their own poor collection efforts or other administrative procedures and those which are attributable to uncontrollable factors, OE could determine a cutoff delinquency rate such as 30 percent and review the management practices of institutions with rates exceeding this limit and the trends in their delinquency rates. As noted, HEW has planned reviews at 2,000 participating institutions which have indications of problems in administering and managing student assistance programs.

Schools which have a delinquency rate of 30 percent or more or which have rates that appear to be increasing because of the schools' poor management practices would be declared ineligible for new capital contributions until they had acted to correct these management weaknesses. This would serve as an incentive for schools to control or reduce Direct Loan delinquency rates.

As mentioned on page 29 existing program legislation requires schools to lend to nearly all eligible students and privacy considerations hamper their attempts to locate borrowers.

These two "uncontrollables" from the schools' viewpoint raise two questions that might warrant consideration.

--Should efforts be made to lower delinquency rates through tightening eligibility requirements, thus eliminating high-risk borrowers from the program?

--Should privacy considerations, which hamper efforts to locate delinquent borrowers, be relaxed?

However, if eligiblity requirements are tightened, some students who deserve Direct Loans might be deemed ineligible if their credit worthiness is a factor in determining eligibility. Also, if privacy considerations are relaxed, individuals' privacy would be sacrificed to some extent in order to enable schools to locate borrowers.

Even if the overall program delinquency rate stabilizes, there will be a continuing need for Federal capital contributions to replenish funds not collected.

CHAPTER 4

RISK PROFILES OF BORROWERS

Because of time constraints we analyzed risk profile information at only 18 of the 19 schools in our review. Direct Loan recipients display different academic, financial, and demographic characteristics. Some of these characteristics can be related to whether the recipients repay their loans on time, which has an impact on schools' needs for Federal capital contributions. Also, by analyzing differences between ontime and delinquent borrowers, 1/ schools can better predict borrower characteristics that will more likely result in a delinquent account.

For the 18 schools, we examined financial aid files and registrars' records, and files of admissions offices and other campus offices to obtain borrower profile information. We then determined frequency distributions for the total sample and each subsample (ontime and delinquent). We performed tests of significant difference concerning these characteristics for each subsample. This chapter addresses the existing situation at the 18 schools and the characteristics which were significantly different between our ontime and delinquent samples.

SAMPLE CHARACTERISTICS

The universe of ontime and delinquent borrowers, as determined from OE's fiscal operations reports as of June 30, 1977, and records at 18 schools included in the risk profile segment of the review, was 13,732

1/Ontime borrowers are those whose repayments have been made on schedule. Delinquent borrowers are those who have missed one or more payments by more than 120 days. Borrowers whose accounts were 1-120 days past due were not included in our sample because these borrowers could display attributes of both ontime and delinquent borrowers.

and 13,397 respectively. 1/ Corresponding sample sizes were 664 and 667.

The ontime group represented 49.9 percent of the total sample, and the remaining students were delinquent. Of those borrowers for whom data was available, demographic characteristics of the two groups combined, were as follows:

--Male and female students represented 51.6 percent and 48.4 percent, respectively.

--White students represented 63 percent; black students represented 30 percent; and hispanics, native Americans, and orientals represented 7 percent.

--The average age of students at the time of their last Direct Loan was 21 years.

--Most students came from families of six members or less, usually with only one member in college.

--About 80 percent of the students were single.

--About 75 percent came from two-parent families living together at the time the student applied for a loan.

--Dependent students constituted 54 percent of the total sample; 26 percent were independent and the rest were not classified.

--Based on budget categories included on need analysis forms, students in our sample were as follows: In-State students residing oncampus (42 percent), In-State commuter students (44 percent),

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1/The reader is cautioned that, although about 50 percent of the borrowers are delinquent, this does not mean the delinquency rate is 50 percent because delinquency rates referred to throughout this report are the result of dollar calculations (not the number of borrowers).

Out-of-State students residing oncampus or commuting (6 percent), and "other" (8 percent).

Some students in our sample received other aid in addition to Direct Loans. For example, 21 percent received Supplemental Educational Opportunity Grants; 23 percent received College Work-Study; 7 percent received Basic Educational Opportunity Grants; 6 percent received Guaranteed Student Loans; 25 percent received State grants; and 9 percent received private scholarships. We did not analyze students' total aid packages.

The majority of students had loans which went into repayment status between 1970 and 1977--with over 50 percent entering repayment between 1974 and 1977. About 70 percent of the students were on a quarterly billing plan. Another 17 percent were billed monthly. Slightly over 36 percent of the students paid their first installment on time; whereas 43 percent did not. We were unable to determine the payment history of the remaining students. We determined that, as of June 30, 1977, 43 percent of the students were actually on time even though the numbers obtained from OE and school records indicated 50 percent were on time. Of those delinquent borrowers for whom information was available, 41 percent had missed more than three payments.

BORROWER PROFILES

We developed profiles of the characteristics most and least associated with Direct Loan delinquency by considering both the significance of the difference between the ontime and delinquent groups on overall factors and the specific breakdown of characteristics within the factors studied. The overall factors studied were demographic, financial, academic, and Direct Loan status. Data was collected on several variables for each factor. Appendix IV describes in detail the development of borrower profiles.

The following table shows the characteristics most and least associated with delinquency.

Characteristics least associated with delinquency	Characteristics most associated with delinquency
White or oriental	Black, hispanic, or native American
Single	Divorced, separated, or widowed
Being an in-State student	Being an out-of-State student
Having proportionately higher levels of parental income, educational cost, family contribution, and assets from summer savings	Having proportionately lower levels of parental income, educational cost, family contribution, and assets from summer savings
Relatively higher grade point averages and scholastic test scores	Lower academic standing and failure to graduate
Significantly higher loan amounts	Significantly lower loan amounts
Being on annual repayment plans	Being on monthly or quarterly repayment plans
Making the first installment on time	Not making the first installment on time

- - - -

The above description of Direct Loan ontime and delinquent borrowers portrays general characteristics which, based on our analyses of sampled records, exhibit a relatively high degree of relationship to loan repayment status. When used as general guidelines in conjunction with other factors involved in the Direct Loan Program, they may provide additional information and insight into the decisionmaking process.

CHAPTER 5

SCOPE OF REVIEW

Our review was conducted at Office of Education headquarters in Washington, D.C., and at 19 post-secondary educational institutions in 9 States. The institutions visited were four 4-year public, four 4-year private nonprofit, five 2-year public, three 2-year private nonprofit colleges, and three proprietary schools.

We examined student aid files, loan account ledgers, and other documents. Using proforma questions for the management practices portion of our review, we interviewed financial aid officials, business officers, and other institutional personnel. We also held discussions with OE headquarters officials.

To assess the delinquency situation at the schools in our review, we calculated (according to the OE method as noted on p. 3) schools' cumulative delinquency rates at June 30, 1977, and compared these rates with those calculated by OE for the 2 previous years. Also, we performed correlation analyses between the cumulative delinquency rates at June 30, 1977, and certain administrative practices at the schools to determine whether adherence to HEW's due diligence criteria was significant in minimizing the delinquency rate. In addition, we calculated annual delinquency rates (using the method noted on p. 16) for the periods ended June 30, 1975, 1976, and 1977.

The 19 schools included in our review of institutions' management of the Direct Loan Program account for about 1 percent of the cumulative outstanding loan volume since the program's inception.

SAMPLE SELECTION--INSTITUTIONS AND STUDENTS

Educational institutions were selected on a judgmental basis, giving consideration to the following:

--Type of school.

--Geographic location.

--Whether the school was receiving new Federal capital contributions.

Student files were selected using random sampling techniques. The purpose of our analyses was to identify student factors (demographic, financial need, academic, Direct Loan status) which may be indicators of delinquency and could be useful in identifying a risk profile of borrowers. Two samples--one for ontime borrowers and the other for delinquent borrowers--were selected. The sample sizes were 664 and 667, respectively. Our analysis focused on identifying characteristics of borrowers which differed significantly between the ontime and delinquent groups.

CHAPTER 6

AGENCY COMMENTS

On April 12, 1978, we discussed the contents of this report with Department of Health, Education, and Welfare officials from the Office of the Secretary and the Office of Education.

These officials told us that for schools to attain a self-sustaining revolving fund status, postsecondary education costs and enrollments would have to remain stable or schools would have to receive massive increases in financial aid. Although student aid has increased, the cost of postsecondary education has also increased significantly. These HEW officials said that even if all delinquent Direct Loan accounts were collected, schools might continue to need Federal capital contributions.

HEW officials noted that borrower characteristics were not included in our correlation analysis of management practices and delinquency. They said that a multivariate correlation analysis of delinquency, management practices, and borrower characteristics probably would have shown that borrower characteristics (see p. 34.) have a greater effect on a school's delinquency rate than do its management practices. Regarding the borrower characteristics most closely associated with delinquency rates, these officials, based on their knowledge of socioeconomic studies, told us that there could be a high correlation among factors such as race, dropouts, and employment status. We agree that this could be true.

Also, they were concerned about our finding that a positive correlation existed between high delinquency rates and the use of commercial billing agents. (See p. 13.) They told us that, in the past, they had encouraged schools with high delinquency rates to use billing agents. A similar correlation was found by the Educational Testing Service study conducted in the early 1970s. (See page 27.)

Other comments have been incorporated in appropriate sections of the report.

United States Senate
COMMITTEE ON THE BUDGET
WASHINGTON, D.C. 20510

October 3, 1977

The Honorable Elmer B. Staats
Comptroller General of the United States
General Accounting Office Building
441 G Street
Washington, D.C. 20548

Dear Elmer:

The General Accounting Office report on the National Direct Student Loan Program, dated June 27, 1977, is of interest to the Senate Budget Committee as it prepares to consider the FY 1979 budget. This letter is a request for a further review by the GAO of the status of the NDSL funds at the institutional level. If, as was intended in the original legislation, the Federal capital contribution is to be lapsed, these funds must move to a revolving status. I am requesting that you conduct a survey of a sample of institutions to identify the status of these funds and to look at factors that explain the apparent differences among institutions in establishing a revolving fund. In particular, we are interested in the management practices characteristic of the institutions and the risk profile of borrowers that impact on the ability to create a revolving fund. We are also interested in determining the delinquency rate and the effectiveness of institutional collection activities, since these factors contribute to the size of the fund and its ability to achieve revolving status as originally intended by Congress.

The answers to these questions will be important to the Budget Committee's review of education funding during deliberations on the FY 1979 budget resolution.

In order to insure the availability of this information prior to the Committee's work on the FY 1979 budget, I would like to receive a report from you by January 31, 1978. Our staffs can meet to work out the details necessary to conduct this survey. Your help in this matter will be greatly appreciated.

With best wishes, I am

Sincerely yours,

Edmund S. Muskie

CUMULATIVE DELINQUENCY RATES AT JUNE 30, 1977, AND REVOLVING FUND STATUS FOR THE 19 SCHOOLS REVIEWED

(note a)

School	Type	Fund Status (note b)	Delinquency rate (percent)
A	2-year public	R-V	78
B	2-year public	R-INV	59
C	2-year public	NR	53
D	2-year public	R-INV	50
E	Proprietary	NR	42
F	2-year private	RV	42
G	4-year private	R-INV	34
H	4-year public	NR	30
I	Proprietary	NR	27
J	2-year private	R-V	26
K	2-year public	R-INV	24
L	4-year public	NR	24
M	4-year private	R-INV	20
N	2-year private	NR	18
O	4-year private	R-V	9
P	Proprietary	R-V	7
Q	4-year private	NR	5
R	4-year public	NR	5
S	4-year public	NR	5

a/ Computed by GAO using OE's former method (see p. 3.)

b/ OE has categorized the schools as:
R-V - voluntarily did not request Federal capital contributions
R-INV - requested but did not receive contributions
NR - requested and received contributions

ANNUAL DELINQUENCY RATES FOR THE 12-MONTH PERIODS ENDED JUNE 30, 1975, 1976, AND 1977

School (note a)	1975	1976	1977	Increase (decrease) in rates from 1975 to 1977	Percentage increase (decrease) in rates from 1975 to 1977
	(----------------	percent----------------	----------------)		
A	84	61	31	(53)	(63)
B	46	64	61	15	33
C	31	34	80	49	158
D	44	43	38	(6)	(14)
E	28	33	50	22	79
F	22	18	27	5	23
G	35	35	21	(14)	(40)
H	57	98	41	(16)	(28)
I	45	63	59	14	31
J	N/A	33	27	b/ (6)	(18)
K	16	20	36	20	125
L	26	19	14	(12)	(46)
M	12	35	23	11	92
N	3	5	25	22	733
O	14	11	14	-	-
P	15	100	100	85	567
Q	14	N/A	8	(6)	(43)
R	6	10	12	6	100
S	10	8	22	12	120

a/ For type of school refer to app. II
b/ Change over a 1-year period
N/A Not available

TECHNICAL APPENDIX

ON RISK PROFILE ANALYSIS

ANALYSIS OBJECTIVE

The purpose of the analysis was to determine whether a relationship exists in background characteristics between students who repay their Direct Loans (ontime borrowers) and those who do not (delinquent borrowers).

Four primary factors were identified for study: demographic, financial, academic, and Direct Loan status. Data was then collected on several variables for each factor. Demographic data included the student's personal characteristics, financial data included the student's and his/her family's financial assets and requirements, the academic factor addressed the student's educational standing, and Direct Loan status included details on individual students' loans. The data was collected from records at 18 preselected schools throughout the United States.

ANALYTICAL APPROACH

Differences among sampled groups can be attributed to

--random variation due to sampling rather than making a 100 percent review of the entire population, or

--an underlying, systematic difference among the groups.

By applying appropriate statistical techniques, it is possible to identify those variables whose observed differences cannot be fully explained by sampling variation. It can therefore be concluded that those variables tend to be related to the subject groups. Our objective was to identify the characteristics of Direct Loan recipients, if any, which exhibit systematic differences between ontime and delinquent borrowers. By evaluating and combining such traits, characteristics most and least associated with loan delinquency were developed. We did not perform a multivariate correlation analysis to determine how a combination of these characteristics relates to delinquency.

METHODOLOGY

The data was analyzed using two statistical procedures: the chi-square test of statistical significance with related measures of association (correlation), and differences between sample means tests. Each is designed to measure the degree of relatedness or dependence of variables. In each case, the dependent variable was defined as Direct Loan payment status (ontime or delinquent). The independent variables were the various characteristics previously cited. The particular statistical test applied depended on how the independent variable was measured. The results of these tests were then used to establish whether or not the differences, in each independent variable, between the groups of ontime and delinquent borrowers were statistically significant. "Significance" in this sense means that our sample differences can be projected to the population, therefore, concluding that a true difference in the two populations of loan recipients existed.

STATISTICAL CRITERIA USED

Where sampling is used, conclusions cannot be reached with absolute certainty. Statistical significance is a measure of the probability that a wrong conclusion can be made. Specifically, it is the probability of concluding that there is a difference between the two groups of borrowers, when in fact, there is no real difference.

Our analyses are based on the generally accepted significance level of no more than 5 percent (95 percent confidence level that we have reached the right decision) with regard to any given variable regarding ontime and delinquent borrowers. Only those variables meeting this criteria were considered to be characteristics serving to distinguish between the two groups. Variables with a significance level of 1 percent or less are interpreted as "highly significant," that is, a high degree of certainty that the groups do, in fact, differ. Also, several measures of statistical association (correlation) between the borrower groups and other variables were considered in determining the significance of relationships.

ANALYSIS RESULTS

Demographic

Only student race showed a highly significant relationship to loan payment status, with about 80 percent of black students delinquent versus 41 percent of white and 11 percent of oriental students.

The variables, marital status, and student type (i.e., in-State versus out-of-State) were significant at the 2-percent level. Divorced, separated, and widowed students tended to have a higher delinquency rate (68 percent) than single students (50 percent). The 72-percent loan delinquency rate among out-of-State students was significantly higher than the 50 percent rate of residents and commuters.

Characteristics which did not show statistically significant differences between the ontime and delinquent groups were sex, student financial status (independent or dependent), age, family size, and employment status at the time the loan was made or at the time of our analyses. There was, however, a relatively high degree of correlation to current 1/ employment status, with 78 percent of the ontime group currently employed versus only 43 percent of the delinquents. The lack of a statistically significant difference for employment status (although there was a high degree of correlation between current employment status and loan repayment status) could result from the small number of sample observations. It is therefore possible that current employment status may affect the delinquency rate, but additional research would be required.

Financial 2/

Average parental total income was about $1,400 (22 percent) greater, cost of education was $250 (10 percent)

1/"Current" refers to the employment status at the time the borrower provided the information to the school.

2/Dollar levels are annual amounts.

greater, and family contribution was $290 (32 percent) greater for the ontime group. In each case the difference was highly significant. There was no significant difference between the two groups on student financial need--the excess of cost of education over family contribution--even though there were differences in the individual components (cost of education and family contribution). Apparently, the ontime group's higher cost of education tends to be offset by the similarly higher amount of family contribution.

Unmet need is defined as the difference between financial need and total aid received (that is, need remaining after all aid has been awarded). Average unmet need was about $109 for the delinquent group and $64 for the ontime group. However, the results were not conclusive due to large variations among all students and the number of cases where unmet need was less than zero. The latter situation arises when financial aid received exceeds financial need. The proportions of delinquent and ontime borrowers with unmet need of less than $1,000 is about equally distributed. As unmet need increased above $1,000, the proportion of delinquent borrowers increased significantly.

The ontime group had significantly higher assets from summer savings, about $100, or 24 percent, than the delinquent group. There was no significant difference between the groups in total aid received.

Academic

Each measure of academic standing showed a highly significant relationship to loan status, with the delinquency rate much lower among the more accomplished students. Over 63 percent of the students who graduated kept their loan payments current, compared to only 35 percent of the nongraduates. The cumulative grade point average was significantly higher in the ontime group (2.7 versus 2.3). Of the students with grade point averages of 2.0 or less, 73 percent were delinquent in their payments. Conversely, of students with averages over 3.0, only 33 percent were delinquent. Scholastic aptitude test scores were also significantly higher for the ontime group (about 34 points higher in the quantitative test and 36 points higher in the verbal test).

Direct Loan status

Variables related to individual loans similarly showed a highly significant relationship to repayment status. The delinquency rate among borrowers on monthly and quarterly repayment plans was significantly higher (51 percent and 53 percent, respectively) than those making annual payments (38 percent). The relationship between delinquency and whether the first installment was made on time was even more pronounced. About 82 percent of the ontime group had made their first payment on time, whereas only 18 percent of the delinquent group had done so.

Loans entering repayment status during 1971 or earlier had a markedly lower delinquency rate (44 percent) than those after 1971 (over 52 percent). The latter rate could become even higher because some recent loans would not yet have had time to become delinquent. This was supported by an additional test that showed almost 59 percent of the loans entering repayment status between 1972 and 1974 as delinquent.

Loan amounts were significantly larger among ontime borrowers. The average amount for the ontime group (loans made during the latest year) was about $83 (16 percent) greater, and the total amount loaned, about $177 (19 percent) greater than those for the delinquent group.

BORROWER PROFILES

We developed profiles of the characteristics most and least associated with Direct Loan delinquency by considering both the significance of the difference between the ontime and delinquent groups on overall factors as described in this appendix and the specific breakdown of characteristics within the factors studied.

Details of these profiles appear on page 34.

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RESPONSIBLE FOR ADMINISTERING ACTIVITIES
DISCUSSED IN THIS REPORT

	Tenure of office	
	From	To
SECRETARY OF HEALTH, EDUCATION, AND WELFARE:		
Joseph A. Califano, Jr.	Jan. 1977	Present
David Mathews	Aug. 1975	Jan. 1977
Caspar W. Weinberger	Feb. 1973	Aug. 1975
Frank C. Carlucci (acting)	Jan. 1973	Feb. 1973
ASSISTANT SECRETARY FOR EDUCATION:		
Mary F. Berry	Apr. 1977	Present
Philip E. Austin (acting)	Jan. 1977	Apr. 1977
Virginia Y. Trotter	June 1974	Jan. 1977
Charles B. Saunders, Jr. (acting)	Nov. 1973	June 1974
Sidney P. Marland, Jr.	Nov. 1972	Nov. 1973
COMMISSIONER OF EDUCATION:		
Ernest L. Boyer	Apr. 1977	Present
William F. Pierce (acting)	Jan. 1977	Apr. 1977
Edward Aguirre	Oct. 1976	Jan. 1977
William F. Pierce (acting)	Aug. 1976	Oct. 1976
Terrel H. Bell	June 1974	Aug. 1976
John R. Ottina	Aug. 1973	June 1974
John R. Ottina (acting)	Nov. 1972	Aug. 1973

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