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ABSTRACT

This report presents an assessment of the U.S. Department of Education's Federal Family Education Loan Program (FFELP) and the new Ford Federal Direct Loan Program (FDLP) by the Advisory Committee on Student Financial Assistance (ACSFA), along with recommendations to help improve FFELP and FDLP. It found that congressional priorities and the positions of the education community contrast dramatically with the Department's overriding interest to move quickly to full scale implementation of FDLP. The report asserts that although the Department has the capacity to manage these student aid programs effectively, it is primarily focusing its resources on the implementation of FDLP, ignoring necessary reforms to FFELP and failing to address program integrity issues in Title IV programs. It concludes that FFELP remains flawed and that FDLP systems and policies cannot ensure program integrity and institutional accountability, and that certain features require modification to support smooth operations as the program expands. Specific recommendations are provided to improve the management, delivery, and operations of FFELP and FDLP. An appendix lists ACSFA members and staff. (MDM)

Integrity and Accountability: Recommendations for Improving the Management, Delivery, and Operations of the Federal Student Loan Programs

A Report of the
Advisory Committee on
Student Financial Assistance

August 1995

INTEGRITY AND ACCOUNTABILITY: RECOMMENDATIONS FOR IMPROVING THE MANAGEMENT, DELIVERY, AND OPERATIONS OF THE FEDERAL STUDENT AID PROGRAMS

A Report to the Congress of the United States
and the Secretary of Education

Advisory Committee on Student Financial Assistance

August 1995

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FOREWORD

Congress created the Advisory Committee when it enacted the Higher Education Amendments of 1986. The Advisory Committee serves as an independent source of advice and counsel to Congress and the Secretary of Education on student aid policy. Congress originally defined its purpose in statute: to provide extensive knowledge and understanding of federal, state, and institutional programs of postsecondary student assistance; to provide technical expertise with regard to systems of need analysis and application forms; and to make recommendations that will result in the maintenance of access to postsecondary education for low- and middle-income students.

The Advisory Committee's structure, which reflects the diversity of the contemporary financial aid community, enables it to provide Congress and the Secretary with objective technical analyses of important student aid issues. College presidents, financial aid administrators, educational association executives, bank officers, guaranty agency executives, state higher education officials, and students have served on the Advisory Committee. Members are appointed by the leaders of the United States Senate and the House of Representatives, and by the Secretary of Education on the basis of technical expertise and knowledge of student aid and educational policy. The eleven members serve in staggered terms of three years. Advisory Committee members and staff are listed in the Appendix.

The findings and recommendations contained in this report result from the Committee's ongoing evaluation of the loan programs and delivery system. They were adopted on June 8 and 9, 1995, and were provided to the Department of Education (ED) at that time. As of the date of this report, no written comment has been received from ED that challenges the findings or recommendations.

The approach to the Committee's congressionally mandated evaluations is independent, objective, and impartial. While members have widely varying professional backgrounds, skills, and professional affiliations, they are required to refrain from acting to benefit interested parties or foster particular programs or policies. Thus, in developing this report, every effort has been made to ensure Congress, the Secretary, and the public that the findings and recommendations are free from the influence of any special interest.

EXECUTIVE SUMMARY

The Advisory Committee on Student Financial Assistance was charged by Congress with the passage of the Omnibus Budget Reconciliation Act of 1993 to conduct a three-year evaluation of the Federal Family Education Loan Program (FFELP) and the Ford Federal Direct Loan Program (FDLP). This report contains the Committee's findings and recommendations for the second year of its evaluation.

The Committee designed the evaluation, and consequently organized this report, to address two of the most important concerns for policy makers within the scope of the Committee's charge. These are the effectiveness and viability of the loan programs, and program integrity and institutional accountability across the Higher Education Act's Title IV student aid programs. As a result, the Committee performed a comprehensive assessment of the FFELP and the FDLP, taking into account the new policy environment, the Department of Education's (ED's) overall management, and issues specific to the loan programs.

The structure of the report reflects the design of the Committee's assessment so that the presentation of the findings and recommendations will be of optimal use to policy makers. The remainder of the executive summary provides an overview of the Committee's observations.

Important changes in the federal student aid program and policy environment pose significant challenges for ED. The Committee found that congressional priorities and the positions of the education community contrast dramatically with ED's overriding interest to move quickly to full scale implementation of the FDLP. Furthermore, ED has taken its position on FDLP implementation in the face of apparent reluctance on the part of institutions to participate and increased congressional scrutiny of all Title IV programs.

The Committee found that ED has the capacity to manage the student aid programs effectively; however, ED is primarily focusing its resources on the implementation of the FDLP, thus ED is ignoring the necessary reform of the FFELP and failing to adequately address program integrity issues in the delivery of all Title IV programs. Of particular concern is that ED has concentrated responsibility and authority for the FFELP, the FDLP, and delivery in one special advisor to the Secretary. The advisor has stated publicly that FFELP reform is not a priority, and the elimination of major deficiencies in the delivery system must await a long-term system redesign.

The Committee's examination of the FFELP shows that despite legislative, ED, and loan industry initiatives, the FFELP remains flawed and lacks essential characteristics that would ensure students and institutions consistent service nationally. The Committee found that the FFELP requires fundamental reform of its delivery system, integrity functions, and certain program features. Attending to FFELP reform is a high priority because the program is likely to continue operating at a significant volume for the foreseeable future. Successful reform will require ED leadership and statutory change as well as loan industry efforts.

The Advisory Committee found that ED successfully created and implemented the FDLP as a feasible and desirable program; however, problems have arisen in the FDLP that ED must address. FDLP has many important and laudable features, such as integrated delivery and institutional loan origination, that have greatly streamlined processing for students and institutions. Nonetheless, the Committee found that FDLP systems and policies cannot ensure program integrity and institutional accountability, and that certain features require modification to support smooth operations as the program expands.

The Advisory Committee believes that the combination of challenges represented by FFEL reform, FDLP improvement, and necessary short-term repair of major delivery problems call for a very different approach. ED must recognize that the three challenges are unique and of equal importance, requiring ED to devote the resources necessary to meet them simultaneously. The current approach--one that recognizes the primacy of FDLP implementation--will allow complexity to reign in FFEL, integrity to be sacrificed in FDLP, and program abuse to continue across all the Title IV programs.

The Advisory Committee believes that these problems can be avoided by a change in the management structure and strategy of ED. This report details the changes required.

INTRODUCTION

Important changes have taken place in the federal student aid program and policy climate in recent months. In light of the potential impact of Congress's budget initiatives on student aid funding, these changes have given rise to a new environment for the Department of Education (ED) as it administers the Title IV student assistance programs. The environment also provides the context for the Advisory Committee's recommendations to Congress and ED. These recommendations are intended to ensure both program integrity and institutional accountability by improving the management, delivery, and operations of these programs, including the Federal Family Education Loan Program (FFELP) and the Ford Federal Direct Loan Program (FDLP).

CONGRESSIONAL AND COMMUNITY PRIORITIES DIFFER FROM ED'S.

Congress and the education community do not support full implementation of the FDLP. This is in contrast to ED's interest in replacing the FFELP with the FDLP as quickly as possible. It is understandable that, in the face of changed congressional priorities and community resistance, ED might pursue a course that implements the FDLP at the expense of FFELP reform. However, the likelihood has increased dramatically that the FFELP will remain the majority loan program. Judged in this light, ED's reluctance to reform the FFELP puts students and institutions at risk.

SHIFTS IN CONGRESSIONAL PRIORITIES POSE NEW CHALLENGES FOR ED.

ED has not adapted its strategies for administering the Title IV programs to address changes in congressional priorities. The different positions ED and Congress have taken on the FFELP and the FDLP provide an illustration. ED is operating as though replacement of the FFELP with the FDLP is imminent, despite congressional opposition to full FDLP implementation. For example, the Senate was virtually unanimous in rejecting the President's 1996 budget proposal, which called for an accelerated implementation of the FDLP to 100 percent by the 1997-98 academic year. In addition, Congress is considering bills introduced by Representative William Goodling (H.R. 530) and Senator Nancy Kassebaum (S.495), which would cap FDLP volume by limiting institutional participation, require similar methodologies to determine the costs of the FFELP and the FDLP, and make minor changes to the FFELP. Broader congressional interest also is developing to make more major reforms of the FFELP. These events have taken place as estimated savings from the FDLP continue to be debated.

CONGRESSIONAL PRIORITIES ARE REFLECTED IN THE POSITIONS OF THE EDUCATION COMMUNITY.

The education associations are opposed to requiring institutions to participate in one loan program over the other. For example, the board of directors for the National Association of Student Financial Aid Administrators adopted a resolution supporting school choice and parallel operation of the FFELP and the FDLP until current authorized time lines expire. Similarly, the National Association of Independent Colleges and Universities has resolved not to take a position on either program, but to evaluate the effects of the FFELP and the FDLP on students and families. The American Association of Community Colleges, the American Association of State Colleges and Universities, the American Council on Education, and the National Association of State Land Grant Universities and Colleges do not favor capping FDLP volume or accelerating implementation, but have not passed resolutions. The student associations hold similar positions.

FDLP PARTICIPATION GOALS ARE NOT BEING MET DUE TO INSTITUTIONAL RELUCTANCE.

Estimates for 1995-96 FDLP loan volume fall below the 40 percent goal permitted by current statute. This indicates that institutions are joining the program at a slower pace than anticipated. ED originally projected 1995-96 FDLP loan volume to be 37 percent. However, this figure is not consistent with either General Accounting Office (GAO) estimates or other data published by ED. GAO analyses of ED data indicate that volume is closer to 28 percent. ED's loan volume figures also cast doubt on the original 37 percent estimate. Specifically, the 1995-96 FDLP institutions announced by ED have a fiscal year 1993 (FY93) loan volume of $5.7 billion, which is 31.8 percent of total volume.

THE TITLE IV PROGRAMS ARE FACING INCREASED SCRUTINY BY CONGRESS.

Congressional activities demonstrate a heightened concern about program integrity and institutional accountability in all the Title IV programs. The student aid programs have been called into question as Congress considers funding reductions to address the budget deficit. For example, the House and Senate have held several oversight hearings from March through July 1995 focusing on program integrity and institutional accountability in the Title IV programs. House and Senate leadership also have corresponded with the Advisory Committee during the past year asking for input on issues specifically related to deficiencies in the Title IV-wide delivery system and integrity in the FFELP and the FDLP.

MANAGEMENT STRUCTURE AND POLICY

The Advisory Committee examined ED's overall management strategy on both a Title IV-wide and program-specific basis. The Committee assessed ED's approach to improving the Title IV delivery system, reforming the FFELP, and implementing the FDLP in a markedly changed program and policy environment. The Committee found that ED has the capacity to manage the student aid programs effectively. However, ED's efforts are primarily focused on implementation of the FDLP. The Committee has developed recommendations to assure that ED administer all the student aid programs equally well.

ED HAS NOT ORGANIZED ITS RESOURCES TO MANAGE BOTH FFELP AND FDLP EFFECTIVELY.

ED's current organization of its functions is fragmented and does not provide adequate administrative support for all the programs. In contrast, integration of systems and policies across the Title IV programs requires an integrated management approach. In an October 1994 reorganization, ED chose a strategy that divides related functions rather than one that coordinates them. The reorganization departs dramatically from a 1991 Office of Management and Budget report that recommended structuring along functional lines.

ED's reorganization has created unprecedented division across the programs by:

- detaching the management of the FFELP and the FDLP from the remaining Title IV programs;
- maintaining FFELP policy under the Office of Postsecondary Education while moving FFELP program oversight to the Office of the Secretary; and
- separating the administration of systems and delivery from the management of the other Title IV programs.

ED has chosen a structure that cannot adequately address its three major management challenges: the redesign of the Title IV delivery system, implementation of the FDLP, and reform of the FFELP. Furthermore, responsibility for both implementing the FDLP and overseeing FFELP reform is concentrated in a special advisor to the Secretary. However, this advisor has stated publicly that FFELP reform is not a priority.

Recommendation: Reintegrate the management structure of the Title IV programs, which currently separates the management of the FFELP and the FDLP from the remaining Title IV programs and separates the policy and program oversight of the FFELP.

ED IS FAILING TO ADDRESS LONGSTANDING FFELP STRUCTURAL PROBLEMS.

ED agrees with the Advisory Committee's assessment that longstanding structural problems exist in the FFELP. However, ED officials announced at an April 1995 Advisory Committee hearing that they have no plans to reform the program.

ED officials have offered two reasons to the Advisory Committee for not considering FFELP reform a priority. First, ED views the program as broken. It believes that without completely restructuring the FFELP, as has been done under the FDLP, reforms will not be effective. Second, ED is charged by current statute to transition from the FFELP to the FDLP and will continue on this course until ED receives a different direction from Congress. As a result, ED has focused its resources on the transition to full-scale FDLP, even though at least 70 percent of the loan volume in 1995-96--and possibly beyond--is likely to be in the FFELP.

Recommendation: Reassess ED's approach to the FFELP and dedicate adequate resources to improving both the FFELP and the FDLP.

ED HAS FAILED TO ADDRESS TITLE IV INTEGRITY PROBLEMS IN THE SHORT RUN.

ED's long-term redesign of the Title IV delivery system does not include interim measures to address existing deficiencies. The current system, which costs $200 million annually, consists of multiple data bases represented by approximately a dozen contracts. Nonetheless, it cannot:

- identify whether or where the student is enrolled;
- prevent multiple awards or overawards;
- prevent awards to ineligible students;
- tie cash drawdowns to disbursements; or
- reconcile accounts in a timely manner.

These deficiencies jeopardize the integrity of all the programs.

The GAO and ED's Office of the Inspector General (IG) have documented these problems. For example, a 1995 GAO report states that ED does not use the data in its systems effectively. As a result, the system has allowed students to receive Pell Grants from two or more schools, obtain FFELP loans greater than their cost of attendance, and obtain Pell and FFELP funds even if in default. The IG stated in a 1994 report that ED could not reconcile over $356 million in Pell Grants for the 1991-92 academic year. The

GAO and the IG were unable to express an opinion on principal financial statements in a 1994 FFELP audit because of ED's ineffective internal controls and unreliable student data. A recent independent audit of the FDLP conducted for the IG by Urbach Kahn & Werlin (UKW) described delays in reconciliation as resulting in untimely accounting for loan disbursements and diminished ability for ED to enforce institutional cash management requirements.

The Advisory Committee has consistently made recommendations to the Secretary to remedy these problems. ED officials have publicly agreed with the Committee's assessment. However, ED continues to pursue a massive and challenging three- to five-year redesign without making interim changes, or developing a contingency plan if the redesign effort stalls or fails. Instead, the redesign relies on full implementation of the National Student Loan Data System (NSLDS), and full development of the Integrated Student Aid Management System (ISAMS), which is only in the initial design phase and years away from implementation.

Recommendation: Reform and integrate the Title IV systems in the short term as well as the long term to reduce exposure to problems that undermine integrity of all the programs, including the FFELP and the FDLP.

ED SYSTEMS AND PROCESSES DO NOT EFFECTIVELY ENSURE PROGRAM INTEGRITY AND INSTITUTIONAL ACCOUNTABILITY.

ED depends on back-end, after-the-fact measures to preserve program integrity and institutional accountability, although ED is engaged in a long-term delivery system redesign. The strategy has three weaknesses. First, ED's systems and processes cannot prevent problems from occurring. Second, existing back-end measures have failed at times to identify problems even after they occur. Third, ED has not always been able to act swiftly to rectify problems after it has detected them.

The GAO and the IG have reported about the absence of effective oversight and program management measures to preserve program integrity and institutional accountability at the front end. With respect to ED's oversight, both the GAO and the IG have raised concerns about the adequacy of ED's gatekeeping functions--that is, its ability to screen out institutions that are likely to perform poorly. The GAO also has stated that ED has not used data in its systems to enforce compliance with federal requirements effectively. In terms of program management, the GAO and the IG have found that ED's accounting procedures and systems controls were not in place to ensure that FFELP financial statements and other management reports are correct. The IG has described poor institutional reporting of data as a cause of hundreds of millions of dollars unreconciled in the Pell Grant program, with the FDLP exposed to the same problem. The Advisory Committee has raised similar concerns in the FDLP with respect to institutional selection and monitoring, and the need for timely institutional reporting of data at the front end.

The Senate Permanent Subcommittee on Investigations has documented that institutions have been able to abuse and defraud the Title IV programs despite the existence of ED's back-end measures. A recent hearing held by the Subcommittee revealed the case of an institution that inappropriately obtained $58 million in Pell Grant funds despite information available to ED. This information included dramatic increases in drawdowns of Pell Grant funds, high FFELP default rates, and negative results from program reviews and audits. This institution stopped participating in the Pell Grant program only after it went out of business.

ED acknowledges that institutions that have been identified as having questionable records can continue participating in the Title IV programs. For example, ED has a backlog of appeals pending from hundreds of institutions with high FFELP default rates. These institutions may obtain FFELP and other Title IV funds for the duration of the appeals process, which can take years. Furthermore, institutions that are terminated from the FFELP are not necessarily precluded from receiving Pell Grant funds. They also use the courts to overturn ED termination rulings.

Recommendation: Reformulate the approach to maintaining program integrity and institutional accountability by implementing front-end rather than after-the-fact measures.

REFORMING THE FFELP

The Advisory Committee concluded in its 1993 loan simplification study that the FFELP was seriously flawed and required reform of its delivery and program features. The Committee made recommendations accordingly to reform the program.

Legislative, ED, and loan industry initiatives have since contributed to improving the FFELP. For example, Congress enacted streamlining measures in the FFELP with passage of the Omnibus Budget Reconciliation Act (OBRA) of 1993 by creating a single program with subsidized and unsubsidized components, and a single variable interest rate for both. ED in conjunction with the education community has developed common paper applications and other forms. In addition, the loan industry made significant strides by working on implementation of electronic loan applications, a network for data transmission, an enrollment status data base, and common guaranty agency and lender policies.

However, the Advisory Committee has found that important FFELP issues still remain that foster continued complexity in the program. Loan industry efforts alone will not be able to address these issues. Instead, further reform of the FFELP will depend on ED leadership and legislative change.

MULTIPLE LOAN DELIVERY PROCESSES CREATE COMPLEXITY AND INEFFICIENCY.

FFELP delivery lacks important characteristics to ensure students and institutions of consistent service nationally. Specifically, FFELP delivery is not integrated into the Title IV delivery system, nor is it standardized within the program. The result is unnecessary complexity and inefficiency for students and institutions that participate in the program.

Statutory change and ED involvement are necessary to integrate FFELP delivery. For example, the Advisory Committee recommended in 1993 that the statute be modified to allow the FAFSA to serve as the loan application, which is a necessary--but not sufficient--step toward integrating FFELP delivery. Legislation has been introduced in both the House and Senate that would authorize this use. However, Congress and ED must take steps to avoid introducing complexity into the application process similar to that eliminated with the enactment of the Higher Education Amendments of 1992. Prior to enactment, millions of students completed nonstandard forms and paid fees. Many also completed multiple forms. As a result, in moving to electronic forms, care must be taken to assure that entities may not field unique versions of the FAFSA with additional and conflicting data requirements.

Standardization is necessary to assure that processes used for the FFELP and other Title IV funds are seamless and delivery is transparent to students and institutions. As long advocated by the Advisory Committee, standardization is an essential component of a national program, especially with the continued presence of many participants in the FFELP. Standardization will require ED, the loan industry, and the education community to agree upon mutual data sets, edits, and procedures to be implemented within specified time frames.

Recommendation: Create a national FFELP delivery system that is integrated into the Title IV delivery system; uses the FAFSA as the loan application; and relies on standardized paper or electronic forms, data, and processes that are developed and revised according to a master calendar.

ED SYSTEMS CANNOT PREVENT INELIGIBLE STUDENTS FROM RECEIVING FFELP LOANS.

ED systems have not been able to prevent Title IV awards, including FFELP funds, to ineligible students. ED is making an effort to improve its systems capabilities in this regard through implementation of the National Student Loan Data System (NSLDS). However, it is unlikely that NSLDS can prevent students from receiving FFELP overawards, or defaulted borrowers from receiving additional loans.

Currently, NSLDS has significant limitations that stand in stark contrast to current financial systems, such as those used for credit and debit cards. First, NSLDS does not operate in real time. For example, ED has informed the Advisory Committee that NSLDS will only be able to detect students with multiple FFELP loans within a 240-day period. As a result, it does not at present--and may not in the future--have the capability to prevent FFELP overawards or disbursements to ineligible students. Second, NSLDS is not structured to catch problems before they occur. According to a recent GAO report, it continues to rely on third parties, such as institutions, to ensure compliance with federal requirements. It also does not collect all the data necessary, such as cost of attendance, to flag overawards. Further, the system does not actively identify students who may be ineligible. Instead, the system must be queried to obtain eligibility data. Third, NSLDS is not yet fully operational. For example, institutional queries are not in place. As a result, institutions cannot yet ask the system to verify student eligibility, making the effectiveness of NSLDS in the short-term questionable.

Recommendation: Redesign the current Title IV delivery system to prevent overawards and awards to ineligible students.

STUDENTS DO NOT HAVE ACCESS TO THE SAME BENEFITS UNDER THE FFELP.

Standardized terms and conditions continue to elude the FFELP. Congress did streamline the FFELP in OBRA of 1993 as recommended by the Advisory Committee by creating a single program with subsidized and unsubsidized components, and a single, maximum interest rate. Nonetheless, key program features, such as repayment options, loan consolidation, and interest rates, can still vary by lender or state.

Lenders and holders have considerable latitude with respect to the specific terms of FFELP repayment options and loan consolidation. In addition, secondary markets in certain states that use tax-exempt financing are able to provide their borrowers with reduced interest rates. Other entities, such as the Student Loan Marketing Association, reduce interest rates by passing savings from reduced collections costs and economies of scale on to certain borrowers. As a result, the repayment provisions available to students depend on the entity that owns their loans. Aside from potential confusion for students that these differences can cause, this means that all students cannot avail themselves of the same benefits.

Legislation introduced in the Senate (S.495) would make FDLP options available under the FFELP. However, the proposed legislation would not standardize terms and conditions within the FFELP.

Recommendation: Standardize terms and conditions across and within the loan programs and reexamine interest rate variation to assure that all borrowers have access to the same benefits.

FFELP PROGRAM FEATURES COMPLICATE REPAYMENT FOR BORROWERS.

FFELP borrowers do not have the options of single source borrowing, refinancing, or income contingent repayment. The absence of these features under the FFELP makes it more difficult for borrowers to manage the repayment of their loans.

Single source borrowing permits borrowers to have their loans originated, guaranteed, and serviced by one entity, respectively. Individual schools and agencies have made efforts to mimic single source borrowing locally. However, these initiatives cannot make it available to students program-wide because FFELP loans are often sold at the option of the lender, not the borrower. As a result, even if a student attends a school that has arrangements with specific guaranty agencies or lenders, single source borrowing for that student is nonexistent as long as the loans can be sold and the student does not have the option to transfer loans to a single entity.

Refinancing--although recommended by the Advisory Committee in its 1993 loan simplification study--does not exist under the FFELP. Students who obtained loans prior to passage of the Omnibus Budget Reconciliation Act (OBRA) of 1993 often contend with portfolios that contain different terms and conditions, including interest rates that may be higher than the interest rates under the current program. Legislation introduced in the Senate (S.495) would make FDLP terms and conditions available under the FFELP. This presents an opportunity to implement the *de facto* refinancing in the current FDLP consolidation loan provisions by allowing borrowers to consolidate their loans at any time, even during the in-school period, at the program's prevailing interest rates.

Income contingent repayment with a loan forgiveness component is not currently available under the FFELP. However, S.495 would extend income contingent repayment to FFELP. To address concerns about the misuse of income contingency by problem schools, ED would have to develop alternative measures to replace cohort default rates for monitoring and evaluating institutional performance.

Recommendation: Implement a single source borrowing rule for all borrowers, require lenders to refinance prior loans at the borrower's option, and include an income contingent repayment option under the FFELP.

CERTAIN DISBURSEMENT RULES ARE BURDENSOME TO INSTITUTIONS WITH GOOD PERFORMANCE RECORDS.

Certain FFELP administrative requirements create unnecessary complexity in the programs. Two disbursement requirements are primary examples. Students currently borrowing from the FFELP are subject to:

- multiple disbursements of single semester loans; and
- a 30-day delay in disbursing loans for first-year, first-time borrowers.

The rules create financial burdens for students and administrative burdens for institutions. Specifically, students depending on loan proceeds to pay for rent and books can experience severe cash-flow problems. In addition, institutions with stable student populations and low default rates must expend resources in terms of systems and staff time to fulfill a requirement that has minimal impact.

. is possible that institutions with good records, either individually or as consortia, will forward proposals to relax these requirements under the Higher Education Act's experimental sites authority. However, modifying the rules to apply to all institutions that perform well would require a statutory change. It would also require that ED put systems in place to prevent abuse.

Recommendation: Modify FFELP disbursement rules to alleviate burdens on students and institutions without jeopardizing program integrity.

IMPROVING THE FDLP

The Advisory Committee has found the FDLP to be a feasible program with important desirable features. These features include integrated delivery, institutional origination, and the availability of income contingent repayment.

The Committee also believes that the program performed remarkably well at the institutional level during the first year of operation (1994-95). This demonstrates that ED has the ability and commitment to manage the program. Specifically, the FDLP proceeded smoothly through origination and disbursement, including approximately:

- 450,000 loans;
- $1.8 billion in FDLP loan originations; and
- 900,000 disbursements to borrowers.

Participating institutions found they could deliver funds on a very timely basis, which dramatically improved service to their students. In addition, institutions received substantial support from ED and its contractors. The support came in the form of generally available customer services, such as publications, training, and information video conferences. In addition, personnel were available to provide assistance for individual institutions as needed.

However, ED faces a set of major management and operational challenges for 1995-96 that must be addressed immediately. This has led the Committee to make the following recommendations to improve the FDLP. The Committee is confident that ED is capable of implementing the recommendations.

CURRENT SYSTEMS AND POLICIES CANNOT ADEQUATELY ENSURE PROGRAM INTEGRITY.

FDLP systems and policies have not been designed to prevent the same problems that occur in the other Title IV programs. As a result, the FDLP is potentially exposed to multiple loans, overawards, loans to ineligible students, and excessive cash drawdowns.

FDLP systems lack the mechanisms to ensure program integrity. For example, the FDLP servicer data base does not include an edit to prevent multiple loans across institutions. Only 104 geographically dispersed institutions participated in the FDLP during 1994-95, which minimized the chances of awarding multiple loans. However, the likelihood of multiple loans occurring increases as the program grows to over 1,300 schools in 1995-96, especially in light of the GAO's findings of multiple awards and overawards in the Pell Grant program, which shares its delivery system with the FDLP. Similarly, ED-supplied software does not have an edit that can flag overawards. The audit conducted by UKW for the IG found that loan limits were exceeded in the first three months of the program's operation.

ED's institutional reporting policy allows most FDLP institutions to draw down funds regularly before reporting any data to the servicer. ED devised this policy to provide institutions with administrative flexibility. The result has been considerable complication with respect to reconciliation and a significant gap between reported drawdowns and disbursements. Furthermore, the policy cannot prevent students from receiving multiple loans, ineligible borrowers from obtaining loans, and institutions from making premature or excessive drawdowns. The UKW audit identified similar problems. They found that lax reporting is a funds control issue for the FDLP and recommended changes to reporting systems and reconciliation procedures as a remedy.

Recommendation: Modify systems and policies in the short run as well as in the long term to prevent multiple loans, overawards, loans to ineligible students, and excessive cash drawdowns.

THE FDLP IS NOT ADEQUATELY PROTECTED AGAINST HIGH-DEFAULT RATE INSTITUTIONS.

Advisory Committee analysis of institutions selected to participate in the FDLP for 1995-96 identified several problems affecting institutional quality. These problems were related to ED's institutional selection process, selection criteria, monitoring, and measures of accountability.

First, the Committee found that the selection process based on FFELP cohort default rates permitted institutions with questionable performance records to enter the program. For example, almost three hundred institutions had default rates of 25 percent or higher in at least one of the three recent fiscal years for which data were available (i.e., FY92, FY91, and FY90). In addition, approximately 150 institutions had default rates of 25 percent or higher for the most recent fiscal year, while close to 60 institutions had default rates of 25 percent or higher in both of the two most recent fiscal years. The Committee's analysis used ED data and was fully corroborated by a subsequent GAO analysis.

Second, selection criteria and administrative processes are not adequate to prevent even more high-default institutions from participating in the FDLP, or to terminate their participation as necessary. Aside from waivers for certain schools servicing largely disadvantaged populations, the criteria as currently structured invite problems in the long run because other selection factors related to administrative capability will be relaxed in future years. In addition, ED's termination procedures, which have not been effective in removing high-default institutions from the FFELP, are not likely to be more effective in the FDLP.

Third, ED does not have a plan to monitor institutions in the presence of the income contingent repayment option. The Advisory Committee fully supports the availability of income contingency. However, it offers new opportunities for mismanagement by institutions of poor quality. While it is still technically possible to be delinquent or in default on an FDLP loan, institutions could avoid this classification by using income contingency as a management tool to mask the consequence of poor educational programs.

Fourth, ED has not identified or analyzed alternative measures of institutional quality in the FDLP in the presence of the income contingent repayment option that will serve the same program integrity function as FFELP cohort default rates. ED has announced plans to issue a notice of proposed rulemaking (NPRM) later this summer to address FDLP cohort default rate calculations. However, ED has given no indication of the specific alternative measures to be proposed. Furthermore, given the timing of regulatory implementation requirements, the regulations would not become final before July 1, 1996 for the 1996-97 academic year at the earliest.

Recommendation:* *Implement an integrated system that can identify, track, and terminate high-default institutions, especially in light of the income contingent repayment option.

ED PROVIDED INCOMPLETE DATA ABOUT PROJECTED FDLP INSTITUTIONAL PARTICIPATION AND LOAN VOLUME.

ED has not provided sufficient information to determine the progress of institutional participation in the FDLP. Data released by ED in November 1994 representing the 1995-96 cohort of institutions have not been updated. In addition, ED may not be collecting the data necessary to estimate loan volume beyond 1995-96.

ED officials have stated throughout the spring that they were not providing an updated list of the 1995-96 FDLP institutions because it was changing daily. They indicated that a list would be available by July 1, 1995, the beginning of the academic year. However, a complete and accurate list of the institutions and their FDLP commitment levels has yet to be published. Furthermore, ED has eliminated the question that asks for estimated FDLP commitment levels on the 1996-97 institutional participation application. As a result, estimating projected FDLP volume will become more difficult.

Recommendation: Resolve outstanding discrepancies that exist in the calculation of FDLP volume; publish accurate information about institutional participation, including Year 3 data; and continue to collect anticipated FDLP commitment levels from institutions applying to participate.

CURRENT ED SYSTEMS AND SOFTWARE ARE NOT ADEQUATE TO MAINTAIN LONG-TERM FDLP OPERATIONS.

ED handled an array of problems with the 1994-95 FDLP systems and software by making numerous mid-year modifications. The approach was sufficient to sustain the program in the first year of operation because only 104 institutions participated. However, these institutions found implementing the modifications burdensome, such as repeated installation of new versions of the ED-supplied institutional software or the reprogramming of institutional systems to accommodate ED's changes.

A similar strategy is not likely to work well for 1995-96 and beyond because many more institutions are participating in the FDLP. Nonetheless, the primary causes that generated the need for frequent modifications have not been addressed by ED. First, ED has developed systems and software without a comprehensive design, a concern raised by the Advisory Committee in its 1994 loan evaluation report to Congress. Second, systems and software continue to be loan-specific, not borrower-specific, for 1995-96--contrary to the way that institutions generally manage information about their students. Third, inadequate coordination of systems and software development have impeded important operational functions such as reconciliation. Finally, current software testing efforts for the 1995-96 cohort of institutions may not effectively avoid the start-up problems that the 1994-95 cohort experienced.

Recommendation: Provide for an external evaluation of ED systems and software, including the adequacy of systems and software testing.

While FDLP processes are largely automated, the promissory note system is paper-based. This can increase the number of steps institutions and students must take to obtain FDLP funds.

THE PROMISSORY NOTE PROCESS CAN BE UNNECESSARILY BURDENSOME.

Institutions must create multiple loan originations and multiple promissory notes for individual borrowers who, within the same academic year, request an increase in FDLP funds in excess of the amount on the original promissory note. However, within statutory limitations, students are eligible for the maximum annual loan amount in some combination of subsidized and unsubsidized loans based on financial need. As a result, implementing a line of credit to replace the current paper-based promissory note system would deliver funds to students more efficiently.

Recommendation: Reevaluate ED policy on a within-year line of credit to streamline the FDLP process for students and institutions.

The statute creates confusion with regard to FDLP disbursement rules. ED has determined that FDLP disbursements should follow FFELP rather than Pell Grant program requirements.

CERTAIN DISBURSEMENT RULES ARE BURDENSOME TO INSTITUTIONS WITH GOOD PERFORMANCE RECORDS.

ED requires multiple disbursements for single semester loans. In addition, all FDLP loans for first-year, first-time borrowers are subject to the 30-day delay prior to disbursement. As discussed in the FFELP section of this report, institutions with low default rates and stable student populations have informed the Committee that current FFELP disbursement rules create burdens for both students and institutions.

Recommendation: Change the FDLP disbursement rules to parallel the Pell Grant program rules without jeopardizing program integrity.

APPENDIX

LIST OF MEMBERS AND STAFF
Advisory Committee on Student Financial Assistance
Current Members by Class of Appointment

CLASS OF 1995
(Term expires September 30, 1995)

Mr. Stephen C. Biklen
President
The Student Loan Corporation
Pittsford, New York 14534
(House of Representatives appointee)

Dr. Stanley Z. Koplik
Chancellor
Higher Education Coordinating Council
Boston, Massachusetts 02108-1696
(U.S. Senate appointee)

Ms. Vernetta P. Fairley
Director of Financial Aid
University of Southern Mississippi
Hattiesburg, Mississippi 39402
(Secretary of Education appointee)

Ms. Carolyn M. Sabatino
Director of Financial Aid and Scholarships
Ohio University
Athens, Ohio 45701
(Secretary of Education appointee)

CLASS OF 1996
(Term expires September 30, 1996)

Ms. Lynn M. Fawthrop
Director of Financial Aid
Roger Williams University
Bristol, Rhode Island 02809
(U.S. Senate appointee)

Mr. Fernando de Necochea
Office of the Associate Provost
Brown University
Providence, Rhode Island 02912
(Secretary of Education appointee)

CLASS OF 1997
(Term expires September 30, 1997)

Dr. Robert E. Alexander
Chancellor
University of South Carolina - Aiken
Aiken, South Carolina 29801
(Secretary of Education appointee)

Ms. Lola J. Finch
Interim Director of Financial Aid
Office of Student Financial Aid
Washington State University
Pullman, Washington 99164-1015
(House of Representatives appointee)

Dr. William C. Hiss
Vice President for Administrative Services
Bates College
Lewiston, Maine 04240
(U.S. Senate appointee)

Mr. Robert A. Kraig
Student
University of Wisconsin-Madison
Madison, Wisconsin 53703
(Secretary of Education appointee)

ADVISORY COMMITTEE STAFF

Dr. Brian K. Fitzgerald
Staff Director

Ms. Ruth Beer Bletzinger
Associate Staff Director

Dr. William J. Goggin
Staff Economist

Ms. Hope Gray
Administrative Officer

Ms. Tracy D. Jones
Staff Secretary

Ms. Ardena Leonard
Assistant Staff Director

Ms. Alicia D. Hurley
Policy Intern