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FEDERAL STUDENT LOAN PROGRAMS: ARE THEY MEETING THE NEEDS OF STUDENTS AND SCHOOLS?

HEARING

BEFORE THE

COMMITTEE ON GOVERNMENT REFORM

HOUSE OF REPRESENTATIVES

ONE HUNDRED NINTH CONGRESS

FIRST SESSION

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FEDERAL STUDENT LOAN PROGRAMS: ARE THEY MEETING THE NEEDS OF STUDENTS AND SCHOOLS?

THURSDAY, MAY 26, 2005

HOUSE OF REPRESENTATIVES,
COMMITTEE ON GOVERNMENT REFORM,
Washington, DC.

The committee met, pursuant to notice, at 10:25 a.m., in room 2154, Rayburn House Office Building, Hon. Tom Davis (chairman of the committee) presiding.

Present: Davis of Virginia, Shays, Souder, Platts, Duncan, Brown-Waite, Porter, Marchant, McHenry, Dent, Fox, Waxman, Kanjorski, Sanders, Maloney, Cummings, Kucinich, Clay, Watson, Lynch, Van Hollen, Sanchez, Ruppersberger, Higgins, and Norton.

Staff present: Jennifer Safavian, chief counsel for oversight and investigations; Robert Borden, counsel/parliamentarian; Rob White, press secretary; Drew Crockett, deputy director of communications; Grace Washbourne, professional staff member; Teresa Austin, chief clerk; Sarah D'Orsie, deputy clerk; Corinne Zaccagnini, chief information officer; Phil Barnett, minority staff director/chief counsel; Kristin Amerling, minority deputy chief counsel; Karen Lightfoot, minority communications director/senior policy advisor; Brian Cohen, minority senior investigator and policy advisor; Earley Green, minority chief clerk; Jean Gosa, minority assistant clerk; Cecelia Morton, minority office manager; and Christopher Davis, minority investigator.

Chairman TOM DAVIS. A quorum being present, the Committee on Government Reform will come to order. I would like to welcome everybody to today's oversight hearing examining Federal Student Loan Programs.

The purpose of this hearing is to discuss the management and performance of the Federal Family Education Loan Program and the William D. Ford Federal Direct Loan Program. Specifically, the committee will focus on the Department of Education initiatives to enhance management and delivery of services to students and schools, as well as highlight the important role of choice in the creation of increased services and streamline delivery in both programs.

Discussions about Federal Student Loan Programs often digress into battles over which program is better, and evolve into debates centering on complex cost estimates. Along with Chairman Boehner on the Education and Workforce Committee, Chairman Nussle of the Budget Committee, and other House and Senate colleagues, we

have asked the Government Accountability Office to examine the accuracy of cost estimates so that we will have accurate and reliable data.

With conflicting studies and reports on costs, it is imperative that Congress have a thorough and independent examination of these factors, and I will await the release of the GAO findings in September and the committees of jurisdiction with the consideration of reauthorization of the Higher Education Act.

In the meantime, today's hearing will focus on the management and performance of both loan programs. We have asked our witnesses the fundamental oversight questions. Are schools and students well served by the current choice of loan programs? Is the Department effectively managing these programs?

Student loan programs must do more than issue loans to students. They have to educate parents and students about their options, when it comes to paying the high costs for higher education. They have to help schools and students comply with the complex procedures to apply for and receive student loans. We need to know, are these programs doing all that they have to do, to make higher education accessible and affordable for all?

I welcome Ms. Theresa Shaw, Chief Operating Officer of the Office of Financial Student Aid, Department of Education; and the Honorable John Higgins, Inspector General of the Department of Education to discuss their successes and the continuing challenges they face in managing Federal Student Loan Programs.

The Department of Education's Student Loan Programs were removed from the GAO's high risk series this past January, and I look forward to hearing about the management improvements that made this possible.

We are also honored to have with us a wide range of student financial experts from schools whose students rely on Federal Student Loans. Each of them has been asked to talk about their institution's history with the Federal Student Loan Program, and to discuss their working relationship with the Department of Education. We also hope they will suggest service improvements and reforms to the Student Loan Program.

During the committee's investigation of Student Loan Programs, we found that 75 percent of our Nation's students choose the FFELP Program over the Direct Loan Program.

Why is that? The answer is, the private sector plays a pivotal role in making higher education affordable and accessible. Lenders, loan guarantors, and other non-profits provide many services that not only help students afford higher education, but also help students who mistakenly believe higher education is otherwise out of their reach.

They also customize their programs for the specific needs of diverse schools and student bodies, and provide financial and life skills training.

For example, the committee has had the opportunity to hear from the State of Virginia's guaranty agency, ECMC, whose foundation created the Realizing the College Dream Program. This program supports teachers, counselors, and community-based organizations in their efforts to help low income and first generation col-

lege students and their families realize that higher education is within their reach.

Through this program, the ECMC Scholars Program, the ECMC Foundation provides millions of dollars in financial aid every year to students in Virginia.

The constant refrain that has emerged from the committee's findings is that schools want a choice in Student Loan Programs, and that the competition between the two main Student Loan Programs has resulted in better benefits and services for their students.

Today, we will hear that choice in the Student Loan Program has resulted in a healthy, competitive marketplace on student financial aid. Choice in Federal student loans has led to major investments in technologies by companies and by the Federal Government, and that choice gives schools the power to demand loan services that best address the financial needs of the students that attend their schools. Along with my colleagues, I welcome you all here today and look forward to today's discussion.

I would just add that I served in Fairfax County Government for 15 years, prior to coming to Congress. We established there a county trash pick-up to compete with the privates, and we allowed neighborhoods to choose. We found out, when the county got in the action, the privates lowered their price and it kept everybody more competitive, giving people a wider choice.

I think, to a great extent, my observations going into this is that this competition has been healthy for students and consumers. Mr. Waxman.

[The prepared statement of Chairman Tom Davis follows:]

Opening Statement
Chairman Tom Davis
"Federal Student Loan Programs:
Are They Meeting the Needs of Students and Schools?"
May 26, 2005

I would like to welcome everyone to today's oversight hearing examining federal student loan programs. The purpose of this hearing is to discuss the management and performance of the Federal Family Education Loan Program (FFELP) and the William D. Ford Federal Direct Loan Program (FDLP). Specifically, the Committee will focus on Department of Education initiatives to enhance management and delivery of services to students and schools, as well as highlight the important role of choice in the creation of increased services and streamlined delivery in both programs.

Discussions about federal student loan programs often digress into battles over which program is better and devolve into debates centering on complex cost estimates. Along with Chairman Boehner of the Education and Workforce Committee, Chairman Nussle of the Budget Committee and other House and Senate colleagues, I have asked the Government Accountability Office to examine the accuracy of cost estimates so that we will have accurate and reliable data. With conflicting studies and reports on costs, it is imperative that Congress have a thorough and independent examination of these factors, and I await the release of the GAO findings in September and the recommendations of the Committees of jurisdiction when they consider reauthorization of the Higher Education Act.

Today's hearing will focus on the management and performance of both loan programs. We have asked our witnesses the fundamental oversight questions: Are schools and students well served by the current choice of loan programs, and is the Department effectively managing these programs? Student loan programs

must do more than issue loans to students. They must educate parents and students about their options when it comes to paying the high cost for higher education. They must help schools and students comply with complex procedures to apply for and receive student loans. We need to know: Are these programs doing all that they must do to make higher education accessible and affordable for all?

I welcome Ms. Theresa Shaw, Operating Officer of the Office of Financial Student Aid, Department of Education and the Honorable John Higgins, Inspector General of the Department of Education to discuss their successes and the continuing challenges they face in managing federal student loan programs. The Department of Education's Student Loan Programs were removed from the GAO's High Risk Series this past January and I look forward to hearing about the management improvements that made this possible.

We are also honored to have with us a wide range of student financial experts from schools whose students rely on federal student loans. Each of them has been asked to talk about their institutions' history with the federal student loan programs and to discuss their working relationships with the Department of Education. We also hope that they will suggest service improvements and reforms to the student loan programs.

During our Committee's investigation of student loan programs, we have found that 75 percent of our nation's students choose the FFELP program over the Direct Loan program. Why? The answer is that the private sector plays a pivotal role in making higher education affordable and accessible. Lenders, loan guarantors, and other non-profits provide many services that not only help students afford higher education, but also help students who mistakenly believe higher education is out of their reach. They also customize their programs for the specific

needs of diverse schools and student bodies, and provide financial and life skills training.

For example, the Committee has had the opportunity to hear from the State of Virginia's guaranty agency, ECMC, whose foundation created the "Realizing the College Dream" program. This program supports teachers, counselors, and community-based organizations in their efforts to help low-income and first-generation college students and their families realize that higher education is within their reach. Through this program and the ECMC Scholars Program, the ECMC Foundation provides millions of dollars in financial aid to students in Virginia each year.

The constant refrain that has emerged from the Committee's findings is that schools want a choice in student loan programs and that the competition between the two main student loan programs has resulted in better benefits and services for their students. Today we will hear that choice in the student loan program has resulted in a healthy, competitive marketplace on student financial aid; choice in federal student loans has led to major investments in technologies by companies and by the federal government; and that choice gives schools the power to demand loan services that best address the financial needs of the students that attend their schools.

Along with my colleagues, I welcome you all here today and look forward to today's discussion.

Mr. WAXMAN. Thank you, Mr. Chairman, and I would like to thank you for calling today's hearing on Federal Student Loan Programs. The committee does not hold hearings on the Department of Education, but the Government's education programs are an important area for oversight.

The Federal Student Loan Program has been a vital resource over the last five decades, providing opportunities for higher education to millions of Americans. Before they finish school, 6 out of 10 post-secondary students have borrowed money through a Government program to help pay for their education. With tuition rates rising much faster than inflation, this Federal assistance is becoming an increasingly vital resource.

The economic return from the student loan investment is easy to see. A more educated society has helped propel the Nation's productivity over the last half century. The Federal Government has two programs to finance student loans: the Direct Loan Program, which is run by the Federal Government, and the Guaranteed Loan Program, which is run by private lenders.

It is clear that the Direct Loan Program has been a huge success. Before its inception, the student loan business was characterized by chaos. Students had to wait in long lines to get their loan checks, and schools had to deal with different forms and procedures for each lender.

By offering schools a more accessible alternative, the Direct Loan Program has sparked reform in the private lending community. In its first 3 years, the Direct Loan Program enticed a third of the participating schools to switch from private lenders. The rapid migration caused private lenders to make rapid upgrades in their services that included streamlining loan administration and offering beneficial financial incentives to borrowers.

The Direct Lending Program has offered an additional benefit to the taxpayer. It is more efficient than its private sector counterpart.

The President's budget shows that when the Government lends the money itself, it cost 14 times less in 2004 than when the Government guarantees loans through private lenders. Since its inception, the program has saved the taxpayer more than $10 billion in lower subsidy costs.

I am not opposed to the Guaranteed Loan Program run by private lenders. Its existence provides competition to the Direct Loan Program, and this competition improves both programs.

But one of the questions we need to resolve is how to protect the taxpayers' interest. It does not make sense that the Guaranteed Loan Program should cost the taxpayers so much more than the Government Loan Program. If the Federal Government is overly subsidizing banks and big lenders to offer these loans, we should reassess these payments.

We also need to examine the financial management of the Federal Student Aid Program. For 15 years, this program has been on GAO's list of programs at high risk of waste, fraud, and abuse. This January, GAO took the Student Aid Program off the watch list. This positive step was a response to a concerted effort at the Department of Education to better track outstanding loans and more thoroughly investigate cases of fraud.

The Department should be congratulated for its progress and encouraged to ensure that it persists. I am glad that we have the Department of Education Inspector General here to tell us about their continued efforts to improve financial management.

I am also pleased that we will hear from a panel representing the Nation's colleges. I would particularly like to welcome Nancy Coolidge, who will be representing the University of California. The U.C. schools have over 80,000 students receiving loans through Federal programs. Because the U.C. schools participate in both the Direct Loan and Guaranteed Loan Programs, she will be able to offer us a valuable and balanced perspective.

Mr. Chairman, the Federal Student Loan Program is a great example of how the Federal Government can provide a boost to low and middle-income families. I thank you for holding these hearings today, and I look forward to learning what we can about how we can make these programs even more effective.

[The prepared statement of Hon. Henry A. Waxman follows:]

Statement of
Rep. Henry A. Waxman, Ranking Minority Member
Committee on Government Reform
Hearing on
"Federal Student Loan Programs:
Are they Meeting the Needs of Students and Schools?"

May 26, 2005

I would like to thank the Chairman for calling today's hearing on federal student loan programs. The Committee does not often hold hearings on the Department of Education, but the government's education programs are an important area for oversight.

The federal student loan program has been a vital resource over the last five decades — providing opportunities for higher education to millions of Americans. Before they finish school, six out of ten post-secondary students have borrowed money though a government program to help pay for their education.

And with tuition rates rising much faster than inflation, this federal assistance is becoming an increasingly vital resource.

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In its first three years, the direct loan program enticed a third of the participating schools to switch from private lenders. The rapid migration caused private lenders to make rapid upgrades in their services that included streamlining loan administration, and offering beneficial financial incentives to borrowers.

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Mr. Chairman, the federal student loan program is a great example of how the federal government can provide a boost to low- and middle-income families. I thank you for holding these hearing today, and I look forward to hearing about how we can make those programs even more effective.

Chairman TOM DAVIS. Well, thank you very much. Since you referred to the second panel, I just would note that we have Dr. Alan Merten, who is a visionary leader at George Mason University, who will be on that second panel, as well, and we look forward to hearing from him.

Mr. WAXMAN. Mr. Chairman, you are probably going to mention it, but there are people from Ohio State University.

Chairman TOM DAVIS. And Maryland, and Dillard University, I was going to get that on the second introduction, but as long as we are home-towning it. [Laughter.]

Mr. WAXMAN. We are looking forward to even hearing from them, even though they do not come from our jurisdiction.

Chairman TOM DAVIS. Well, we are looking forward to hearing from all of them. But you have to recognize that Dr. Merten votes in my district, as well, and I did not want to get upstaged.

Mr. WAXMAN. I give up. [Laughter.]

Chairman TOM DAVIS. Are there any other opening statements? I know Mr. Souder has an opening statement.

Mr. SOUDER. Yes, I appreciate the chairman for yielding me a few minutes. As a senior member of the Education Committee, and as chairman of the oversight committee that has jurisdiction over the subcommittee on this committee on education, I wanted to make it absolutely clear that I believe it is important to have private sector alternatives.

We, on the Education Committee, and I was Higher Education Subcommittee for 6 years, have declared a truce, Chairman Boehner and Chairman McKeon, between those of us who believe that direct lending ought to be eliminated, and those who believe that the private sector ought to be eliminated. We have had a working truce to make sure there is a level playing field.

The statistics show that, in fact, private sector lending has been much more effective. I believe that previously, the Federal Government gave us misleading, deceitful statistics about how mixed and fixed costs were allocated, which made direct lending seem cheaper.

It also shows that when you keep a level playing field, for example in my district, 10 of the 12 institutions of higher learning are not direct lending. They have moved to the private sector and, in fact, have moved to the private sector at an increasing rate.

It is important, as we debate this, that we understand that much like when we deal with questions in Postal reform and others, when the Federal Government tries to bury their fixed and mixed cost, and then claim they are beating the private sector, I would hope Members of Congress have enough economic sense to understand that difference.

I yield back.

Chairman TOM DAVIS. I thank you very much. Are there any other Members? The gentleman from Baltimore.

Mr. CUMMINGS. Thank you very much, Mr. Chairman, and I thank you for holding this very important hearing.

As Congress considers the reauthorization of the Higher Education Act, we must embrace our moral obligation to ensure that those who wish to better themselves through a post-secondary education are able to achieve that goal unobstructed by the barrier of financial disadvantage. Federal Student Aid Programs reflect our

commitment to that obligation by helping needy students and families afford a higher education, who would otherwise be unable to do so.

In today's world of global competition, transformation, and increased expectations of employee qualifications, there can be no doubt of the importance of a post-secondary education. In fact, the Bureau of Labor Statistics recently reported that a post-secondary education would be essential for 42 percent of the jobs created in this decade.

The U.S. Census Bureau reaffirmed the value of a post-secondary education, reporting that those with a Bachelor's Degree earned, on an average, $1 million more over their lifetime than those with only a high school diploma.

With record budget deficits, dramatic tuition increases, and the growing necessity of post-secondary education, the need to ensure that our Federal student loan programs are effective and efficient has never been greater. The two major student loan programs operated by the Federal Government include the Federal Family Education Loan Program and the Ford Federal Direct Loan Program.

Under the FFELP or Guaranteed Loan Program, private lenders supply the loan capital and the Federal Government assumes the risk by guaranteeing the loan against the borrower's default. Under the FDLP or Direct Loan Program, loans are financed directly to the students, using the U.S. Treasury funds.

In fiscal year 2004, approximately $52 billion was distributed to 12½ million college students and their families through Federal Student Loan Programs. Moreover, 25 percent of these loans were made through the Direct Loan Program, with the larger 75 percent share made through the Guaranteed Loan Program.

It is unfortunate, however, that more institutions did not utilize the Direct Loan Program as it is over 10 times less costly to the taxpayer than the Guaranteed Loan Program.

While improvements in the Guaranteed Loan Program such as the implementation of standard forms and procedures should be recognized, I am deeply troubled that these reforms had little impact on the overall cost to the taxpayer.

The Washington Post reported that the President's own budget for fiscal year 2006 shows that "for every $100 spent on student loans, the U.S. Government pays $12.09 of subsidy on Government-guaranteed loans, and only 84 cents for direct loans." In contrast, from 1992 to 2004, the Direct Loan Program saved taxpayers approximately $10 billion in subsidy costs.

I believe we have a common goal in following common sense. For this reason, I have co-sponsored the Student Reward Aid Act, introduced by Representative Petri and Representative Miller.

This legislation would encourage institutions of higher education to participate in the Student Loan Program that is most cost-effective for taxpayers. If more institutions utilized the Direct Loan Program, we would achieve substantial cost savings and direct those savings to grant aid such as Pell Grants.

Finally, Mr. Chairman, in the wake of an announcement that the University System of Maryland's in-State undergraduate tuition would rise in the fall by 5.8 percent, a Towson University student in Maryland was quoted in the Washington Post as saying, "You

are not offering a higher education to everyone. You are only offering it to people who can afford it."

In clear and plain terms, there is something wrong in America when capable and driven students are denied access to a higher education for financial reasons.

By improving Federal Student Aid Programs, we open the door of opportunity to more students. Mr. Chairman, by providing students in our Nation with access to an affordable, high-quality, post-secondary education, we help save our children and generations yet unborn from the clutches of poverty, crime, drugs, and hopelessness. What can be more necessary? What can be more important?

I look forward to the testimony of all of today's witnesses, and especially recognize Ms. Sarah Bauder of the University of Maryland, my alma mater. I yield back the balance of my time.

[The prepared statement of Hon. Elijah E. Cummings follows:]

Opening Statement of

Representative Elijah E. Cummings, D-Maryland

Hearing on "Federal Student Loan Programs: Are They Meeting the Needs of Students and Schools?"

Committee on Government Reform
U.S. House of Representatives
109th Congress

May 26, 2005

Mr. Chairman,

Thank you for holding this vitally important hearing on federal student loan programs.

As Congress considers the reauthorization of the Higher Education Act, we must embrace our moral obligation to ensure that those who wish to better themselves through a postsecondary education are able to achieve that goal unobstructed by the barrier of financial disadvantage. Federal student aid programs reflect our commitment to that obligation by helping needy students and families afford a higher education who would otherwise be unable to do so.

In today's world of global competition, transformation, and increased expectations for employee qualifications, there can be no

doubt of the importance of a postsecondary education. In fact, the Bureau of Labor Statistics recently reported that a postsecondary education would be essential for 42% of the jobs created in this decade. The U.S. Census Bureau reaffirmed the value of a postsecondary education reporting that those with a bachelor's degree earned on average $1 million more over their lifetime than those with only a high school diploma.

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12.5 million college students and their families through federal student loan programs. Moreover, 25% of these loans were made through the direct loan program, with the larger 75% share made through the guaranteed loan program. It is unfortunate however that more institutions did not utilize the direct loan program as it is over 10 times less costly to the taxpayer than the guaranteed loan program.

While improvements in the guaranteed loan program such as the implementation of standard forms and procedures should be recognized, I am deeply troubled these reforms have had little impact on the overall cost to the taxpayer.

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Miller. This legislation would "encourage institutions of higher education to participate in the student loan program that is most cost-effective for taxpayers." If more institutions utilized the direct loan program, we could achieve substantial cost savings and direct those savings to grant aid such as Pell Grants.

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I look forward to the testimony of all of today's witnesses and especially recognize Ms. Sara Bauder of the University Maryland. I yield back the balance of my time.

Chairman TOM DAVIS. Thank you very much.

Yes, Mr. Duncan.

Mr. DUNCAN. Mr. Chairman, thank you for once again calling a hearing on a very important topic. Several columnists and education experts have pointed out that since the start of the Federal Student Loan Program in 1965, college and university tuition and fees have gone up at about three or four times the rate of inflation.

For many years, there was little opposition to increases, because students were told not to worry, they could just get a low interest Government loan.

Now many young people are getting out of school with huge student loan debts, especially if they have gone to a private school. The average student loan debt is now $18,900. But it is not uncommon for those who have gone to private universities or colleges to get out with $50,000 debts, or if they go to graduate school, too, even $75,000 or $100,000 debts.

According to College Board and the Bureau of Labor Statistics, tuition and fees have increased almost 300 percent in the last 20 years. While inflation over that same period has been 84.7 percent. If the figures since 1965 are included, the increase over the rate of inflation is even greater.

There is now so much concern, that legislative remedies are being considered. In the March 8th U.S. News and World Report of last year, Editor in Chief Mortimer Zackman wrote an editorial about this problem.

He noted there was a 14 percent increase in tuition last year alone at public 4-year colleges and universities. He said, "Only the well off can now afford a college education these days." Nothing will happen this year. But if these whopping increases continue, the Congress will be forced to take action.

In a new book, called "Going Broke by Degrees: Why College Costs Too Much," Richard Vetter wrote this. He said, in 1958, the annual tuition at Northwestern University was $795. In the fall of 2003, the tuition for new students was $28,404. An estimate of the 2003 median family income indicates that Northwestern's tuition would be over 53 percent of an average family's incomes.

If the ratio of Northwestern's tuition to median family incomes rises by the same rate over the next 45 years, as it did over the previous 45 years, the tuition then would represent almost 2 years of a median family's incomes. That will just be impossible to bear for mini-families.

I can tell you a very common thing for me, for parents and grandparents to bring me their college graduate young people. These are good looking young people with good grades, and they are unable to find jobs.

So what is happening, because we have sent so many millions of good jobs to other countries for so many years now, many students cannot find the good jobs that they used to be able to find with just Bachelors Degrees, when I was in college.

So all the young people are working as waiters and waitresses in restaurants, and they are going on to Graduate School. But then, sadly, they are finding out that they cannot find good jobs, even sometimes with Graduate Degrees and huge student loan debts. This is a very serious problem that is growing very fast. If

colleges and universities do not start doing more to hold down these whopping increases, Congress is going to have to take action. Thank you, Mr. Chairman.

Chairman TOM DAVIS. Thank you very much.

Does anyone else wish to make a statement? Ms. Norton.

Ms. NORTON. Mr. Chairman, this hearing on the management of Education Loan Program could not be more timely. Inflation in tuition is outflanked only by inflation in health care in our country. We have gotten to the point, of course, where parents do not so much pay for college tuition as students do, with the effect that millions of young people are not going to college at all with the rise in the inflation tuition.

Those who do go and take these loans find that they are retarded in their start in life. Many of them have to take job only based on whether the jobs pay enough money to allow them to pay their student loans and to make a living. They are moving in with their parents. We have to do something about this effect on young people.

The Direct Loan Program has had the desired effect, it seems to me, because it has encouraged changes in the Guaranteed Loan Fund, and it has encouraged lenders to do what the private sector is most capable of doing, and that is to engage in innovations that attract even more students and parents to their program.

But the difference in the costs of these two programs, Mr. Chairman, is simply indefensible. We have to come to grips with that difference. You can explain away this or that part of it. But the fact is that these are huge differences, and these subsidies do not go to the student. They do not go to education. These subsidies go to the private sector.

We have to demand far greater efficiencies from them than they have been able to produce, since the Direct Loan Program demonstrated that you can indeed provide this service at a much reduced amount than had been done previously.

Mr. Chairman, I am particularly grateful for the work you have done on the D.C. College Access Act. That has caused me to follow these costs in a way that I did not before. You and I know that despite the fact that Congress has been generous in trying to keep up with the costs of this act, that it has become almost impossible to do.

Indeed, tuition in the United States is going up at an average rate of 14 percent annually. This is not sustainable. Anything we can do to cause a U-turn on these costs, not just gradually reduce these costs over the next generation. But a U-turn on these costs is going to be necessary if, in fact, we intend to encourage young people to go to college at the rate they will need to go in order to keep our country competitive.

I am very interested in this hearing, and I am grateful that you called it today, Mr. Chairman.

Chairman TOM DAVIS. Thank you. Let me just say that we are not trying to engage here in a cost issue. But there are some issues on costs that we do not have all the facts. That is why we have asked GAO to come back and look at this.

In past reports, GAO has hinted at problems in revenue data. The Department of Education data shows that direct lending sub-

sidy costs have been underestimated by billions of dollars. But we don't really know, and we are going to wait for that GAO report to come back in.

What we are looking at today is not the cost debate, but it is an oversight hearing on the management and performance of the two largest student programs. I would like to keep the emphasis there, because from my perspective, we could throw out all the numbers we want, but until we get that GAO report, at this point we really don't know what we are talking about.

Mr. Ruppersberger.

Mr. RUPPERSBERGER. Very quickly, Mr. Chairman, a lot has been said. I think we all agree that students who are deserving, regardless of their ability to pay, we need to get them educated. The economic viability and long-term success of the Nation is dependent upon its ability to enroll, educate and graduate students. The Federal loan program is the single largest source of student financial aid.

Unfortunately, with the increase of college tuition, many students who enroll in college will not be able to afford to stay until graduation. The efforts of the Department of Education to bring accountability to its programs are essential. If we ensure accountability among the borrowers and the programs that are responsible for day to day operations, it will send a clear message that these funds should be used for educational purposes only.

The U.S. Department of Education should further its programs to teach borrowers about the official use of the money and require students to prepare budget plans for any additional use. Thank you.

[The prepared statement of Hon. C.A. Dutch Ruppersberger follows:]

Congressman C.A. Dutch Ruppersberger
Committee on Government Reform Oversight

"Federal Student Loan Programs: Are They Meeting the Needs of Students and Schools?"

Statement:

Thank you Mr. Chairman for holding this oversight hearing regarding the federal student loan programs.

As we continue to discuss how best to improve our system of education, we must provide the resources necessary to help deserving students attend any college or university regardless of his or her ability to pay. There may be no better time than the present for this nation to do so, a time when the economic viability and long term success of the nation is dependent upon its ability to enroll, educate and graduate students.

The federal student loan program is the single largest source of student financial aid. In fact, according to recent data from the College Board, students received more than $105 billion in financial aid for undergraduate and graduate study in 2002-03, with more than $70 billion

coming from the federal government. Of that, nearly $48 billion was available through federally-guaranteed student loans.

Millions of students finance higher education with the help of federal student loans. According to the U.S. Department of Education, for FY 2004 more than $52 billion is available to students and parents through the traditional, Federal Family Education Loan (FFEL) program and the government-run Direct Loan (DL) program. Since FY 1995, student loans have increased from $23 billion to $52 billion, an increase of 123 percent.

Unfortunately, with the increase of college tuition, many students who enroll in college will not be able to afford to stay until graduation.

The efforts of the U.S. Department of Education to bring accountability to its programs are essential. If we ensure accountability amongst the borrowers and the programs that are responsible for the day-to-day operations it will send a clear message that these funds should be used for educational purposes only. The U.S. Department of Education should further its

programs to teach borrowers about the official use of the money and require students to prepare budget plans for any additional use.

This may be a little far-reaching. However, it may ensure less fraud and abuse in federal loan programs.

We need to do more to help those young people who are striving for success. I look forward to hearing the testimony of the witnesses and asking questions.

Thank You

Chairman TOM DAVIS. Do any other members wish to make opening statements?

If not, we will move to our first panel. We are expecting votes shortly, so I would like to get your testimony in. We may have to take about a 15 minute recess, then we will come back and finish.

We have Ms. Theresa Shaw, who is the Chief Operating Officer of the Office of Federal Student Aid at the U.S. Department of Education, and the Honorable John P. Higgins, Inspector General of the U.S. Department of Education. Thank you both for being with us.

It is our policy to swear witnesses in before you testify, so if you will raise your right hands.

[Witnesses sworn.]

Chairman TOM DAVIS. Thank you so much.

Ms. Shaw, we will start with you.

STATEMENTS OF THERESA S. SHAW, CHIEF OPERATING OFFICER, FEDERAL STUDENT AID OFFICE, U.S. DEPARTMENT OF EDUCATION; AND JOHN P. HIGGINS, JR., INSPECTOR GENERAL, U.S. DEPARTMENT OF EDUCATION

STATEMENT OF THERESA S. SHAW

Ms. SHAW. Good morning, Chairman Davis, Ranking Member Waxman, and members of the committee. Thank you for inviting me to testify today.

I am Terri Shaw, the Department of Education's Chief Operating Officer for Federal Student Aid. I am pleased to be here representing Secretary Spellings, the Department, and the very talented and dedicated Federal Student Aid staff.

The Department of Education's grant, loan, and work programs represent the largest source of student aid for post-secondary education in the United States. In 2004, these programs provided approximately $69 billion to more than 10 million students and their families.

Federal Student Aid, under the direction of the Secretary, is charged with operational responsibility for oversight and administration of all the Department's Federal student financial assistance programs and as one of the Government's few performance-based organizations, upholds high standards of operational efficiency, innovation, and customer care.

To carry out these purposes, Federal Student Aid is focused on delivering world-class customer service, developing award-winning products and services, effectively managing the programs to ensure fair and effective oversight, and providing service delivery at the lowest cost without sacrificing quality.

I would like to share some statistics that illustrate the size and scope of our enterprise. We receive and process over 14 million FAFSA aid applications each year. We have dramatically transformed the FAFSA process from a 100 percent paper to nearly 90 percent Web-based.

We are the single largest lender of student loans, annually originating nearly $13 billion in new loans. We service the $87 billion outstanding portfolio of Direct Loans. The Department, through Federal Student Aid, provides over $12 billion in Federal Pell

Grants to more than 5 million undergraduate students each year. We are responsible for collection on the $17 billion defaulted student loan portfolio, and we manage and monitor $500 million in contracts under which our major business processing functions are performed.

We are particularly proud of the Department's and Federal Student Aid's recent achievement of a major President's management agenda, Government Accountability Office and departmental objective by reducing the vulnerability of the Federal Student Aid programs to risk. In January 2005, GAO removed the Federal Student Aid programs from its high risk list. Additionally, in March 2005, we achieved all green status on the scorecard used by the Office of Management and Budget for monitoring our progress and status.

You asked me to highlight some of the initiatives that resulted in these achievements. Simply stated, the Department made reducing vulnerabilities in the programs and the removal of the Student Aid Programs from the High Risk List a top priority. We institutionalized sound financial management and received clean audit opinions for the past three fiscal years. Working with all participants across the program, the cohort default rate was reduced from an all-time high of 22.4 percent to an all-time low of 5.2 percent.

We implemented ongoing processes to identify risk and have several initiatives underway, including a joint task force with the Department's Office of Inspector General to identify real or potential risks. We developed a multi-year sequencing plan for system and business process integration. Our two principal initiatives re-engineer our front end and back end systems and business functions, and together will save taxpayers an estimated $1½ billion.

Our independent customer satisfaction scores for our electronic FAFSA are comparable to UPS, Mercedes Benz, and Amazon.com; for our direct loan servicing, better than Wachovia Bank and similar financial services institutions. And for our Pell Grant and Direct Loan origination, better than e-Trade. The Department is committed to ensuring the integrity and viability of both the Federal Family Education Loan and Direct Loan program. The availability of choice has made both programs stronger through competition, has been the catalyst for innovation, has forced standardization of data exchange methods, and most importantly, has appropriately directed the focus on service to students and parents and to the higher education institutions who are on the front lines serving them.

Your invitation asked me to suggest recommendations for legislative changes needed to improve the management of the Federal Student Aid program. Changes may be necessary in the Performance-Based Organization authorizing legislation. The Department is in the process of developing its legislative recommendations for the upcoming reauthorization of the Higher Education Act. Any changes related to human capital management will complement the administration's Government-wide Civil Service reform, announced in the fiscal year 2006 President's budget.

I believe that in order for Federal Student Aid to be made most effective, it must be able to operate more like a private sector business than a traditional Government agency. I am fully aware of

however, of our special responsibilities to taxpayers, employees and our business partners.

I would also like to highlight a legislative proposal that the administration has supported for several years: an amendment to Section 6103 of the Internal Revenue Code that would allow for the matching of student aid applicant data with IRS tax information. We believe that if this change is enacted, we could eliminate many burdensome processes that are currently used to verify student aid applicant data and further simplify the process for applicants, their families and schools.

Additionally, we could significantly reduce improper payments due to inaccurate income reported by applicants. For example, reducing these improper payments could lead to significant cost savings of approximately $300 million annually in the Pell Grant program.

In closing, I am honored to be part of Secretary Spellings' team and the Department of Education, an organization that plays such a central and essential role in our Nation. We ensure that all eligible Americans can benefit from federally funded financial assistance for education beyond high school, and we consistently champion the promise of post-secondary education for all Americans and its value to our society.

On behalf of the Secretary, the Department, and the Federal Student aid staff, thank you all for the opportunity to share with you our performance and accomplishments. I would be pleased to answer any questions the committee may have.

[The prepared statement of Ms. Shaw follows:]

Written Testimony of
Theresa S. Shaw
Chief Operating Officer
Federal Student Aid
U.S. Department of Education

To the
House Committee on Government Reform
Oversight Hearing on Federal Student Loan Programs
May 26, 2005

Introduction

Chairman Davis, Ranking Member Waxman and members of the Committee, thank you for inviting me to testify today. I am Terri Shaw, the Department of Education's Chief Operating Officer for Federal Student Aid, a position I have held since September 2002. I am pleased to be here representing Secretary Spellings, the Department and the very talented and dedicated Federal Student Aid team to discuss the administration of the Federal student financial assistance programs in general, and the Federal Family Education Loan (FFEL) and William D. Ford Federal Direct Loan (Direct Loan) programs in particular.

I am also especially pleased to discuss initiatives that resulted in two significant accomplishments of the Department and Federal Student Aid – the recent attainment of a green status on the President's Management Agenda Scorecard for Elimination of Fraud and Error in the Student Aid Programs and Deficiencies in Financial Management and the removal, this past January, of the student aid programs from the Government Accountability Office's list of High-Risk programs.

The Department of Education's grant, loan, and work programs represent the largest source of student aid for postsecondary education in the United States. In 2004, these programs provided approximately $69 billion to more than ten million students and their families.

Work and Responsibilities of Federal Student Aid

Federal Student Aid is charged with operational responsibility for oversight and administration of all the Department's Federal student financial assistance programs under Title IV of the Higher Education Act of 1965 (HEA) and, as one of the government's few Performance-Based Organizations, upholds high standards of operational efficiency, innovation and customer care.

The Higher Education Amendments of 1998 established Federal Student Aid, under the Direction of the Secretary, as the Federal Government's first Performance-Based Organization, with particular emphasis on modernizing the delivery of the Federal student assistance programs. The authorizing statute provides that the purposes of the Performance-Based Organization are to:

- increase accountability;
- improve service to students;
- integrate information systems;
- implement a common integrated delivery system;
- strengthen program integrity; and
- reduce costs of administering the programs.

To carry out these purposes, Federal Student Aid is focused on:

- delivering world-class customer service;
- developing award-winning products and services;
- effectively managing the programs to ensure fair, effective and appropriate oversight; and
- service delivery at the lowest cost without sacrificing service levels or quality.

I want to share with the Committee some statistics that illustrate the size and scope of the Department's Federal student aid enterprise. The Department's Federal Student Aid office ensures the availability and accessibility of the Free Application for Federal Student Aid (FAFSA) to students and parents and receives and processes FAFSAs for over 14 million aid applicants each year. We have dramatically transformed the aid application process from a 100 percent paper process to one that is now nearly 90 percent web-based.

The Department's Federal Student Aid office is the single largest originator of student loans, annually making over three million Direct Loans totaling nearly $13 billion to two million student and parent borrowers. Each year, we originate over 300,000 Direct Consolidation Loans totaling $7 billion. We service the $87 billion outstanding loan portfolio of 18 million Direct Loans made to more than seven million borrowers. We are responsible for collection on $17 billion of defaulted student loans, including Direct Loans, FFEL and Perkins Loans. We oversee the approximately $390 billion outstanding student loan portfolio, including loans held by lenders, guaranty agencies, and schools. The Department provides over $12 billion in Federal Pell Grants to five million undergraduate students each year. Our systems process millions of financial and other transactions annually and our websites receive 20 billion hits each year. We handle more than 40 million inbound and outbound phone calls through our customer care centers. And each year we send more than 41 million pieces of mail to aid applicants and borrowers.

Federal Student Aid contracts with a number of private sector providers for our major business functions, including application processing, disbursement and payment processing, customer call center operations, data center operations, and default portfolio collections. Federal Student Aid staff manages and monitors these contracts and the service delivery provided. Our contracting of business processing is a practice used by others in the higher education funding community, including many lenders and servicers in the FFEL Program. In fact, we contract with some of the same providers that FFEL lenders use. Federal Student Aid's contracts total $500 million annually and employ an estimated 6,000 contract staff, located throughout the United States. I should note that we have created innovative contract solutions to optimize the investment of taxpayer dollars and the return on that investment. For example, our contracts with private collection agencies have performance-based evaluation incentives. This resulted in an increase of defaulted loan recoveries from $670 million to $1.25 billion over a four-year period while collection costs were reduced from 18 percent to 16 percent – a decrease of 11 percent.

Federal Student Aid is also responsible for providing outreach services and materials to students, schools, families, and community agencies. We provide training, both in-person and, increasingly web-based, and technical support for our delivery partners. We also create and distribute a number of publications designed to remind, inform, and instruct students and their families.

Fair and effective oversight and monitoring of the approximately 6,000 institutions of higher education that participate in the programs is also one of Federal Student Aid's core responsibilities, as is our oversight of the nearly 3,500 lenders, guaranty agencies, and servicers that participate in the FFEL Program.

Our oversight activities include real-time, and near real-time, quality control. We have built into our systems and processes edits, triggers, risk assessments and other features that enable us and our partners to monitor and correct errors; and to provide early warnings of potential trouble. In addition, we monitor our school and lending community delivery partners by reviewing required annual compliance audits and financial statements, performing on-site program reviews, and analyzing partner-specific data to detect trends and areas that could be of concern.

We are particularly proud of the Department's and Federal Student Aid's recent achievement of a major President's Management Agenda (PMA), Government Accountability Office (GAO) and departmental objective by reducing the vulnerability of the Federal student aid programs to fraud, waste, abuse and mismanagement. As a result of the Department's specific focus on reducing these vulnerabilities, in January of 2005, GAO removed the Federal student aid programs from its High-Risk list. The student aid programs were placed on the High-Risk list when the list was created in 1990. Additionally, the PMA Scorecard for Elimination of Fraud and Error in Student Aid Programs and Deficiencies in Financial Management achieved "all green" on status and progress on March 31, 2005. In your hearing invitation you asked me to highlight some of the initiatives that resulted in these achievements.

Simply stated, the Department and Federal Student Aid made reducing vulnerabilities in the programs and the removal of the student aid programs from the High-Risk list a top priority. We

developed very specific action plans and regularly monitored our progress. We held all levels of management and staff accountable for accomplishing the tasks specified in the action plans.

We institutionalized sound financial management and received clean audit opinions in Fiscal Years 2002, 2003, and 2004 with no material weaknesses in Fiscal Years 2003 and 2004.

Federal Student Aid also focused on student loan default prevention and management through default prevention strategies implemented by participants across the programs. The combined FFEL and Direct Loan cohort default rate was reduced from an all-time high of 22.4 percent in Fiscal Year 1990 to an all-time low of 5.2 percent for Fiscal Year 2002, a dramatic 77 percent reduction.

Federal Student Aid engages in an ongoing process of actively identifying risks in the programs. Noncompliance with statutes, regulations and policies by schools, lenders, guaranty agencies, and servicers not only places Title IV funds at risk, but erodes the public trust in the programs. We have several initiatives underway, including a joint task force with the Department's Office of the Inspector General, to identify real or potential risks for fraud, waste, abuse and mismanagement in the programs. Federal Student Aid also established an Enterprise Risk Management unit to better coordinate risk monitoring and action plans among our various business units and with other Department of Education offices.

We developed a multiyear sequencing plan for system and business process integration, completing several of the scheduled initiatives and are continuing to make significant progress on future deliverables. We are integrating and reengineering many of our existing systems and functions. Our two principal initiatives are "ADvance", an integration of our front-end business processes of aid awareness, application processing, origination and disbursement, web services, and customer service; and "Common Services for Borrowers" (CSB), our integrated processes of Direct Loan servicing, Direct Loan consolidation and default collection. The innovative contracting solutions for ADvance and CSB could save taxpayers an estimated $500 million and $1 billion, respectively, over the possible ten-year terms of these contracts. Continued

investment in system integration projects, such as ADvance and CSB, is required to ensure these projected savings.

As I mentioned, the financial aid application process has been transformed from 100 percent paper to nearly 90 percent electronic. In fact, electronic processing has been implemented in all phases of the financial aid process. From learning about student aid and the advantages of a postsecondary education by accessing web-based materials, through the application process, to electronically signing promissory notes and the disbursement of funds, and finally to the repayment of loans; students can successfully manage their financial aid lifecycle without ever seeing or handling a piece of paper. This is accomplished through a series of secure, user-friendly, and efficient electronic processes that have simplified the financial aid process for students and families. And, of course, we also have eliminated virtually all paper in our financial and data transactions with our delivery partners: schools, lenders, guaranty agencies, and servicers.

Our most recent customer satisfaction scores for our electronic FAFSA, as measured by the American Customer Satisfaction Index (ASCI), were comparable to UPS, Mercedes Benz, and Amazon.com. Similarly, our scores for our Direct Loan Servicing operation were better than for Wachovia Bank and similar financial services entities and our customer satisfaction scores for Pell Grant and Direct Loan origination and disbursement surpass the scores received by E-Trade.

We also implemented a comprehensive and strategic human capital management plan. The plan provides a detailed roadmap for addressing Federal Student Aid's critical workforce issues, including leadership development and succession planning. As part of this plan, we aligned individual staff performance plans, including those for Federal Student Aid's senior officials, to the accomplishment of our strategic objectives.

Federal Student Aid is realizing efficiencies, productivity gain, and capital savings through our many initiatives enabling us to manage significantly increasing workloads, at lower marginal operating costs. For example, for Fiscal Years 2002 – 2004, the number of FAFSA applications,

Direct Loan borrowers, collection accounts, and Pell Grant recipients increased 11 percent, 8 percent, 4.5 percent, and 18 percent, respectively.

While we are justifiably proud of the Department's and Federal Student Aid's accomplishments over the past several years, we understand that the focus, attention, and accountability that led to these achievements should always have been in place. It should not be a newsworthy event that clean financial audits are received or that the student aid programs are not on the GAO High-Risk list. We are supposed to get clean audits and we are supposed to exercise proper oversight and management of the programs.

FFEL and Direct Loan Programs

As you know, there are three Federal student loan programs, the smallest of which is the campus-run, Federal Perkins Loan Program. The two larger programs, and the ones this hearing is focused on, are the FFEL and Direct Loan Programs. While there are two programs, there is but a single mission and a common goal – to ensure that low and middle-income students and their families can afford the costs of postsecondary education. Both programs have the same eligibility requirements and provide the same annual and aggregate borrowing limits. Loans in both programs have essentially the same terms, conditions, and benefits to borrowers, including deferments, forbearances, and repayment options.

The delivery and funding models, however, are different. Under the Direct Loan Program, the Federal Government is the lender with loan funds provided directly from the Federal Treasury. The borrower repays directly to the Federal Government. The Federal Government, with support from FSA's private contractors, performs all collection activities on defaulted loans and assumes the risk of default, interest rate fluctuations, and discharges.

Under the FFEL Program, private financial institutions are the lenders and use their own funds to make loans. Borrowers repay directly to the private lender, or its agent. The private lenders perform all servicing activities. State and not-for-profit guaranty agencies perform collection activities on defaulted loans. Through a series of reimbursements and interest benefits, the

Federal Government assumes virtually all of the risk of default, interest rate fluctuations, and discharges for the FFEL Program, much the same as for Direct Loans.

Annually, about $13 billion in loans are made to nearly two million Direct Loan borrowers and about $39 billion in loans are made to over five million FFEL borrowers. Additionally, each year nearly $8 billion in Direct Consolidation Loans are made to over 300,000 borrowers and $36 billion in FFEL Consolidation Loans are made to over one million borrowers. At the end of Fiscal Year 2004, the outstanding Direct Loan portfolio was $87 billion and the outstanding FFEL portfolio was almost $260 billion: 25 percent and 75 percent, respectively, of the combined $347 billion non-defaulted outstanding portfolio.

There are many participants in the two programs. There are over 1,000 institutions of higher education that participate in the Direct Loan Program, and as I previously mentioned, the Department is both the lender and the servicer. In the FFEL Program there are about 5,000 institutions and nearly 3,500 lenders, servicers, and State and private non-profit guaranty agencies that insure the lender against default and obtain reimbursement by the Federal Government.

What is most critical, I think, to this discussion is the role that Federal Student Aid plays in the administration and oversight of these two loan programs. Federal Student Aid is the discrete management unit, reporting to the Secretary, responsible for managing the operations and functions supporting these programs as well as the other Title IV programs.

As a Performance-Based Organization, our job is pretty clear: deliver world-class customer service; develop award-winning products and services; effectively manage the programs to ensure fair, effective, and appropriate oversight; and provide service delivery at the lowest cost without sacrificing service levels or quality.

The Department is committed to ensuring the integrity and viability of both the FFEL and Direct Loan programs. The availability of choice has made both programs stronger through competition, has been the catalyst for innovation, has forced standardization of data exchange

methods and, most importantly, has appropriately directed the focus on service to students and parents, and to the institutions of higher education that are on the front-lines serving them.

Your invitation asked me to suggest recommendations for legislative changes needed to improve the management of the Federal student loan programs. As a Performance-Based Organization, Federal Student Aid is granted by Congress certain limited managerial flexibilities over our budget, procurement, and human capital management activities. We are aggressive in using these flexibilities to meet our objectives and we will continue to explore additional flexibilities that we can take advantage of under current law. I believe that in order for Federal Student Aid to be most effective, it must be able to operate more like a private-sector business than as a traditional government agency – fully aware, however, of our special responsibilities to taxpayers, employees, and our business partners.

In addition, changes may also be necessary in the Performance-Based Organization authorizing legislation. The Department is in the process of developing its legislative recommendations for the upcoming reauthorization of the Higher Education Act. We intend to work closely with the authorizing committees as we consider possible changes to the statutory language for the Performance-Based Organization. Any changes related to human capital management will complement the Administration's government-wide civil service reforms announced in the FY 2006 President's Budget.

With respect to the programs themselves and our operational and administrative responsibilities, I would like to highlight a legislative proposal that the Administration has supported for several years, and is included in the President's Fiscal Year 2006 Budget: an amendment to section 6103 of the Internal Revenue Code that would allow for the matching of student aid application data with IRS tax information. We believe that, if this change is enacted, we could eliminate many burdensome processes that are currently used to verify student aid applicant data, and further simplify the process for applicants, their families, and schools. Additionally, we could significantly reduce student aid improper payments due to inaccurately reported income by applicants. Reducing these improper payments could lead to significant cost savings of approximately $300 million annually in the Federal Pell Grant Program.

There is, of course, no lack of student aid simplification proposals under consideration both within and outside of government as the Congress approaches reauthorization of the HEA. We in Federal Student Aid monitor many of those discussions and, when appropriate, offer our comments and suggestions. I believe that your colleagues on the authorizing committees will be looking at these proposals and we are, of course, ready to provide whatever analytical and programmatic support that is needed.

I am honored to be part of Secretary Spellings' team and the Department of Education, an organization that plays such a central and essential role in our Nation. Federal Student Aid ensures that all eligible Americans can benefit from federally funded financial assistance for education beyond high school and we consistently champion the promise of postsecondary education for all Americans – and its value to our society.

On behalf of the Secretary, the Department and the Federal Student Aid staff, thank you for the opportunity to share with you our performance and accomplishments.

I am pleased to answer any questions you may have.

Chairman TOM DAVIS. Thank you very much.
Mr. Higgins.

STATEMENT OF JOHN P. HIGGINS, JR.

Mr. HIGGINS. Mr. Chairman and members of the committee, thank you for the opportunity to appear before you today to discuss the management and the performance of the Federal and Direct Loan Programs.

As you know, these loan programs are large and complex and through the Department disperses or guarantees tens of billions of dollars every year. Like these and other student aid programs that were recently removed from the GAO high-risk list, an accomplishment for which Ms. Shaw and her staff should be commended, nevertheless, they continue to present significant management and oversight challenges.

Last December, Terri and I initiated a joint effort to identify patterns of fraud and abuse in the Student Aid programs and to recommend improvements. We called this the OIG-FSA Joint Fraud Initiative. Working in collaboration, our staff has identified 11 risk categories that represent areas in the life cycles of the programs that are vulnerable to fraud and abuse. We have established work groups to focus on the three categories that begin the student aid process and that have been the subject of frequent audits and investigations. I will focus on these three risk areas today.

The first risk area is the falsification on the pre-application for Federal student aid. Information contained in this application determines an individual's initial eligibility. False information on the application, particularly under-reporting of income, often results in an applicant receiving student aid to which he or she is not entitled.

The Department has not estimated the effect of mis-reporting of income on the student loan programs. However, it has estimated that $365 million in Pell Grants were over-awarded in fiscal year 2003, because applicants understated their income. This problem has grown since my office first identified this in 1997 an estimated amount to be $177 million of over-awards in fiscal year 1996.

The second risk area category is identity theft. Identity theft typically occurs when a person intentionally uses someone else's name, Social Security Number and date of birth to fraudulently obtain student aid. People who obtain loans through identity theft almost always default on these loans.

Our investigations continue to aggressively pursue individuals who steal by mis-using the identities of others. For example, we found an individual in Arizona who used more than 50 identities, typically those of inmates serving long prison terms, to obtain over $316,000 in loans and grants. This scheme was unraveled when a sharp financial aid administrator at a local community college recognized the thief as the person who had previously picked up another loan check belonging to another identity.

As a part of his plea agreement, the individual described his scheme in an interview with us. We have included his interview in this educational DVD intended to increase awareness of i.d. theft. We have provided copies of this DVD to Department officials, cam-

pus police, Members of Congress and your committee staff. I would be happy to supply more if you would like.

The third risk area is school fraud and abuse. Over 6,000 schools participate in the student aid programs and the Department relies upon these schools to properly account for and administer the funds. Fraud and abuse by school owners and officials has been a longstanding problem for the Department. While fraud and abuse does occur at non-profit and public sector schools, historically the majority of my resources has been devoted to fraud and abuse involving proprietary schools. In fact, over the last 6 years, 74 percent of the schools involved were proprietary schools.

In my written testimony I provided you with information on the other risk areas of the fraud initiative. I also discussed my work plans for the following year and recommended legislative changes. This concludes my statement. I would be happy to answer any questions.

[The prepared statement of Mr. Higgins follows:]

Statement of John P. Higgins, Jr.
Inspector General
Department of Education

Before the
House Committee on Government Reform
United States House of Representatives

May 26, 2005

Chairman Davis and members of the Committee, I would like to thank you for the opportunity to testify today about the management and performance of the Federal Family Education Loan Program (FFEL) and the William D. Ford Federal Direct Loan Program (Direct Loan), within the U.S. Department of Education (Department). As you requested, I will provide information on the high-risk areas in the federal student loan programs identified through our on-going fraud initiative that we have undertaken with the Department's Office of Federal Student Aid (FSA). I will also discuss our related Work Plans for fiscal years 2005 and 2006, as well as touch upon legislative changes that, based on our work and findings, are needed to improve the management of these programs.

For 25 years, the Office of Inspector General (OIG) has worked to promote the efficiency, effectiveness, and integrity of the Department's programs and operations. We conduct independent and objective audits, investigations, inspections, and based on our findings, make recommendations to the Department. Our staff of about 290 includes financial, information technology and program auditors, criminal investigators, inspectors, computer intrusion experts, management and budget analysts, and attorneys. We have staff in 14 locations, including Puerto Rico and the Virgin Islands. As the Department's budget and responsibilities have grown, we have continued our commitment to identify and help the Department combat waste, fraud and abuse in its programs and services. We have increased our efforts to identify emerging threats to the integrity of the Department's programs, such as identify theft and information security, and together with the Department, are creating new mechanisms to improve our work in finding and helping to reduce fraud and abuse in the federal student loan programs.

I. Background on the Student Loan Programs

The Department's student loan programs are large, complex, and inherently risky due to their design, reliance on numerous entities, and the nature of the borrower population. The loan programs rely upon over 6,000 postsecondary institutions, more than 3,000 lenders, 35 guaranty agencies, and many contractors to assist in the administration of the programs. Last year, the Department disbursed and guaranteed approximately $50 billion in new loans, and managed a loan portfolio approaching $400 billion for these programs.

In 1990, the Government Accountability Office (GAO) placed the student financial assistance programs on its high-risk list. The Department responded by developing plans and continually working to improve its financial management and internal controls, integrating information systems, and creating a balanced management approach to minimize noncompliance sufficient to satisfy GAO. GAO removed the program from its high-risk list in January of this year, but cautioned, as it did so, that the Department must continue its progress and take additional steps to address remaining weaknesses in the administration of its programs.

Effective oversight is important with the increased variety of delivery methods used to provide education to students, (*i.e.*, non-traditional terms and distance education) together with the virtually paperless electronic delivery of program funds. These developments create new challenges to ensuring adequate oversight to identify, assess, and manage the risks in these programs.

II. OIG/FSA Fraud Initiative

In late 2003, we conducted an analysis of patterns of fraud, and abuse in student financial assistance programs. We completed this analysis and developed suggestions for preventive measures, and provided them to the FSA. In 2004, my office drafted a plan to estimate the amount of fraud in the loan programs. Prior to beginning the effort, I asked Terri Shaw, Chief Operating Officer of FSA if she and her staff were interested in making this a joint project. She was interested and, following some discussion on how to proceed, we decided to combine our expertise and develop a proactive approach to identifying and reducing fraud and abuse in these programs, as well as addressing related management issues. Thus, the OIG/FSA Fraud Initiative was launched in December 2004.

This collaborative effort brings together OIG and FSA personnel with extensive audit, investigative, inspection, program, and systems/data knowledge. For the purposes of this project, the team defined fraud as the "intentional effort to unlawfully obtain student financial assistance funds or benefits that a person is not entitled to," and we defined abuse as "non-compliance with statutory and regulatory requirements or obtaining more student financial assistance funds than entitled."

Our initial strategy session covered the life cycles of the programs, from the students' or parents' application for aid through the repayment/discharge of their loan obligations. We discussed known fraud and abuse areas within the student financial assistance programs, existing weaknesses in program control, as well as potential and emerging areas of vulnerability. Based on the expertise of the group's participants, 11 high-risk categories were identified: Free Application for Federal Student Aid (FAFSA) falsification, identity theft, fraud and abuse at schools, E- Signature/Personal Identification Number (PIN), distance education, lender fraud and abuse, guaranty agency abuse, loan discharges, loan consolidations, monitoring contracts in the Direct Loan program, and risks specific to the Perkins Loan Program.

The group selected three key issues to focus on during the first phase of the project: 1) FAFSA falsification, 2) identity theft, and 3) fraud and abuse by schools. These categories were selected as they begin the student financial assistance process, and all have been the subject of frequent OIG audits and investigations. Subsequent categories will be analyzed later this year.

In February 2005, the OIG/FSA Fraud Initiative team established three working groups, comprised of six to eight OIG and FSA personnel, to focus on the first three risk categories. The teams are meeting throughout the year to gain a thorough understanding of each issue, process, and existing management controls, or controls circumvented. They are developing profiles of known fraud and abuse to identify patterns, research existing data from internal sources through the use of data mining techniques, and consider information from external sources. Based on their findings, they will produce work plans with timelines and milestones for effectively addressing these issues.

Consistent with the focus of the hearing, the information and examples that I provide below center on the risks in the FFEL and Direct Loan programs, and omit any discussion of the Perkins Loan program. While OIG and FSA jointly selected these risk areas, I will illustrate them with examples of the work performed by OIG only.

FAFSA Falsification

False information on the FAFSA, particularly underreporting income, continues to be a significant problem in the student financial assistance programs, and often results in the individuals receiving student financial assistance to which they would not otherwise be entitled. Information contained in the FAFSA, the document that begins the process for an applicant to receive student financial assistance, determines an individual's initial eligibility. Questions on the FAFSA include citizenship, educational level, filing status (*i.e.*, dependent or independent), income, assets, and number in household in postsecondary education. This information is used to determine basic eligibility through a series of data matches with other systems, and statutory formulas are used to compute the Expected Family Contribution (EFC). The EFC is critical in calculating the amount of student aid the applicant is eligible to receive.

Underreporting income on the FAFSA impacts eligibility for student loan programs, as income is a critical factor in determining whether the student is eligible for a subsidized or an unsubsidized loan. Underreporting of income also consumes valuable institutional resources to attempt to verify applicant income, and can victimize unsuspecting students and parents through the actions of unscrupulous financial aid consultants seeking personal financial gain. The Department has not estimated the effect of misreporting of income on the student loan programs. However, to demonstrate the impact of misreporting income, it has estimated that $365 million in Pell grants were over-awarded because applicants understated their income in fiscal year 2003. OIG first estimated over-awarding of Pell Grants due to underreported income in 1997. At that time, our estimate was $177 million for award year 1995-96.

Congress can immediately correct this problem, and help the Department better identify potential FAFSA income falsification, by amending the Internal Revenue Code to allow the Department to match the information provided on FAFSAs with the income data that is maintained by the Internal Revenue Service. While the Higher Education Act (HEA) has been amended to permit this match, a corresponding amendment to the Internal Revenue Code has not been enacted. The Department has been working with the Office of Management and Budget (OMB) and the Congress for additional authorizing legislation.

My office continues to investigate cases of students and parents providing false income and other information on the FAFSA to obtain student financial assistance for which they are not entitled. We also investigate financial aid consultants advising individuals to provide false information on the FAFSA. For example, a joint OIG/U.S. Postal Inspection Service investigation led to the conviction and sentence of an individual whose actions resulted in an estimated loss to the government of over $1 million, with a potential loss in grants and loans totaling over $10.7 million. The individual held seminars at churches and universities, instructing and assisting individuals in preparing and submitting FAFSAs that falsely identified them as "orphan/ward of the court," indicated dependency upon a single parent or grandparent, or quantified household income. The investigation disclosed that the individual met with approximately 400 students per year and charged the families between $250-$350 for his assistance. The individual was sentenced to 41 months incarceration, followed by five years supervised release, and was ordered to pay over $716,000 in restitution

Identity Theft

Identity theft is one of the fastest growing crimes against consumers and poses a risk in the student financial assistance arena. Identity theft typically occurs on the FAFSA when a person intentionally uses someone else's name, Social Security number and/or date of birth (DOB) to fraudulently obtain student financial assistance. People who obtain loans through identity theft almost always default on those loans.

Our OIG investigators continue to aggressively pursue individuals who steal by misusing the identity of others. For example, our office recently conducted an identity theft investigation in Cedar Rapids, Iowa that involved a conspiracy by 6 family members in which 41 identities were used to fraudulently obtain over $400,000 in student financial assistance. Some identities were obtained through identity theft, while individuals who expected to receive some of the proceeds from the scheme provided others. One of the defendants was responsible for recruiting 11 of the individuals whose identities were used. Most of the individuals whose identities were used lacked high school diplomas or GED certificates and were not eligible student financial assistance recipients. The defendants completed FAFSAs using their own addresses with the identities they obtained. They enrolled these individuals in online courses at a local community college. The school disbursed excess funds by mailing checks to the defendants' addresses, and

the defendants retained the majority of these funds for their personal use. The defendants in this case pled guilty primarily to student financial aid and/or conspiracy charges.

Another OIG investigation found that an individual in Arizona used more than 50 identities, typically those of inmates serving long prison sentences, to obtain over $316,000 in loans and grants (both FFEL and Pell grants involved). This scheme unraveled after a financial aid administrator at a local community college recognized the perpetrator, who had recently presented himself with a different identity in order to obtain a loan check, now seeking additional monies with yet another identity. As part of his plea agreement, the individual described his scheme, and his interview was used as a part of an educational DVD that has been distributed to Department program officials, campus police departments, and Members of Congress. I have provided copies to the Committee staff and would be happy to supply more.

OIG and FSA continue to jointly alert students to the threat of identity theft via our special campaign website, www.ed.gov/misused, which provides information on scams, suggestions for preventing identity theft, and resources on how to report identity theft involving federal education dollars. We also sent information on preventing identity theft to guaranty agencies and more than 50 college newspapers.

School Fraud and Abuse

Over 6,000 schools participate in the student financial assistance programs, and the Department relies on these schools to properly account for, and administer the funds. Fraud and abuse by school owners and officials have been a long-standing problem for the Department. It is a high-risk area that remains vulnerable. While fraud and abuse does occur at non-profit and public sector institutions, historically, fraud and abuse predominantly involves proprietary schools. In fact, over the last six completed fiscal years the majority – approximately 74 percent -- of our institutional fraud cases involved proprietary schools.

Proprietary schools have also evolved into two classes of institutions, privately held and as part of much larger publicly traded corporations. Both are driven by profit, but publicly traded institutions are also driven by growth. Over the years, we have identified rapid growth as one risk factor for abuse in the programs, through impaired administrative capabilities resulting in abuse or fraud. Examples of significant fraud and abuse we continue to find in school administration of the student financial assistance programs are refund violations and ineligible students, programs and locations.

Refund violations have been a longstanding problem in the student financial assistance programs, and it continues to challenge the Department. Refund violations are triggered when a student ceases to attend an institution. The institution must determine if a refund is owed, calculate the amount of the unearned student financial aid funds, and return those funds to the Department, the FFEL loan holder, or to another applicable participant in the student financial assistance program within a specified number of days. Violations of this requirement occur when refunds are not paid timely, when incorrect calculations

result in returning insufficient funds, and when institutions fail to pay refunds at all, which is a criminal offense under the HEA. We have found all three types of refund violations in our audits, and these violations are the most frequent subject of our investigations.

Our office continues to find ineligible students due to falsification of high-school equivalence, ability-to-benefit exam results, not performing (or falsifying) required verification of income for selected students, and identity theft. We have found programs that do not meet the minimum requirements for program participation and additional institutional locations that did not meet the basic eligibility requirements. These are not frequent occurrences, but they continue.

As an example of the type of fraud we find in this area, my office recently conducted an investigation in Michigan related to the William Tyndale College (WTC). In March 2001, the WTC president and one vice president purchased the assets of a closed computer learning school and renamed the school the NorthStar Institute of Technology (NorthStar). Our investigation developed evidence that the WTC president and two vice presidents fraudulently misrepresented the NorthStar students as WTC students, using WTC's eligibility to apply for and receive student financial assistance funds for the NorthStar students. Between April 2001 and September 2001, NorthStar students, through WTC, were awarded $943,025 in student financial assistance funds, of which $517,414 was disbursed to WTC. Approximately $318,000 was then funneled to NorthStar.

E-Signature/PIN

Protecting FSA's e-signature/PIN process is critical, as those PINs can be used not only to submit a FAFSA, but also to enter binding legal transactions, incur obligations to repay money, and control student aid accounts. While FSA encourages students to keep their PINs confidential and avoid disclosing them either intentionally or inadvertently, more needs to be done to ensure that the person using the PIN is the person actually authorized to do so. We have found at least one commercial site that assists in the completion of the FAFSA for a fee and encourages applicants to provide their PINs in order to do so. Addressing this risk is particularly critical as the number of FAFSAs filed electronically has increased significantly in the last two years.

Distance Education

The risk in distance education is ensuring students are actually enrolled and complete these courses. Schools may never have an in-person relationship with the student, making it more difficult to ensure the correct identity for the recipient of student financial assistance. The rapid growth of distance education, specifically via the internet, combined with the virtual paperless electronic delivery of student financial assistance funds contributes to this challenge

Lender Fraud and Abuse

With over 3000 lenders participating in the FFEL program, ensuring that each of these lenders is performing due diligence when servicing loans poses a challenge to the Department, and therefore a risk. Lender operations are complex, and lenders vary greatly in size. Billions of dollars are paid annually paid in subsidy costs, which are billed at an aggregate level. Further, errors in billings can result in millions in improper subsidy payments.

As an example of how critical due diligence is, we recently became aware that the New Hampshire Higher Education Assistance Fund (NHHEAF) notified FSA during 2002, that it discovered that it had assigned a large loan balance incorrectly under the category of loans billed at the 9.5 percent Special Allowance Payments. FSA required NHHEAF to calculate the overpayments, and have the recalculation reviewed by a certified public accountant firm. NHHEAF repaid the Department over $10 million for overpayments during a several year period, including several thousand dollars in compounded interest.

Guaranty Agency Abuse

The ability to ensure that the 35 guaranty agencies involved in the FFEL program are carefully reviewing default claims to assure that proper due diligence was performed by the 3,000+ lenders and maintaining correct balance in the guaranty agencies' Federal and Operating Funds poses another challenge to the Department, and therefore was identified as a risk by the Fraud Initiative team.

We recently completed an audit of the Illinois Student Assistance Commission's (ISAC's) review of lender due diligence and found ISAC's claim review process was not adequate to ensure that it claimed reinsurance only if the lender exercised due diligence in servicing the loan. As a result of the problem identified at ISAC, we performed survey reviews at five of the largest guaranty agencies and found a similar lack of compliance.

Loan Discharges

The adequacy of the Department's new system to identify loan discharges is a concern, and significant enough to be considered a risk. In June 1999, OIG issued an audit reporting a significant lack of controls and abuse of the process to have student loans discharged due to disability and death of the borrower. In response to that audit, FSA implemented an entirely new process for disability discharges and implemented improved controls over discharges for death. Due to a wide range of complaints received by FSA over its process, we initiated an audit to assess the process and controls of its new system, which we will complete later this year.

Loan Consolidations

Lender non-compliance with regulations and, in some cases, fraud, present a risk in this area. Historically low interest rates have made the loan consolidations very attractive to

borrowers over the last several years. We have received a series of complaints regarding the activities of entities involved in loan consolidations and have completed an audit and several investigations.

We recently completed an audit of the Direct Consolidation Loan program and identified 65 FFEL lenders that did not return information required on the loan verification certificate (LVC), citing either the single-holder rule or asserting that the applicant was otherwise ineligible for a Direct Consolidation Loan. The single-holder rule does not apply to Direct Consolidation Loans, and lenders are not responsible for determining a borrower's eligibility for a Direct Consolidation Loan. If the Department did not receive a completed LVC, the loan was not consolidated. Instead, the Department sent a letter to the borrower, telling him or her that the loan could not be included in the consolidation unless the borrower successfully persuaded the loan holder to provide the information.

From the investigation side, based on our work, the owner/president of a debt collection agency in Arizona and four of his employees were indicted on 37 counts of bank fraud, student loan fraud and conspiracy. The individuals allegedly conspired to prepare fraudulent applications for consolidated student loans, so as to generate for themselves more than $1 million in commissions. The bank handling the loans on behalf of the Department approved 537 of the loans worth more than $3.6 million. Borrowers subsequently defaulted on 213 of the loans, causing a loss to the bank of $1.4 million. No payments had been made by the borrowers on a majority of the original defaulted loans. The four employees have pled guilty and one has been sentenced. The trial of the owner is in progress, and the other three employees will be scheduled for sentencing after the completion of the owner's trial.

Monitoring Contractors in the Direct Loan Program

The risk in this program is conducting adequate monitoring of the contractors administering it (from origination through servicing of the loans). Oversight of the contractors is critical to the operation of the program, including ensuring adequate performance measures are established in the contract and ensuring deliverables are specific and monitored.

To demonstrate the impact of inadequate monitoring, we recently performed two audits of the Common Origination and Disbursement (COD) System, vital to the Direct Loan operations. On the audit of the COD contract, we found that contract requirements were not tied to COD performance, FSA lacked adequate oversight of contract deliverables, and FSA did not ensure continuation of service and adequate audit access to the system. In our audit of the COD system, we found numerous ongoing system interface and system balancing errors between COD and the Department's financial management systems, and ongoing problems with COD not automatically generating and linking student promissory notes with the student loan records, and COD not consistently providing schools with updated records, due to delays in processing batch information.

III. OIG Annual Work Plan

Through our annual work planning process we request suggestions from the Department, OMB, and Congress, on where to focus our limited resources. Our Work Plan is designed to support the management challenges we have identified for the Department, as well as the President's Management Agenda. As a result of this process, nearly 50 percent of OIG's work and resources are committed to the student financial assistance programs – their financial management, systems, operations, and activities.

Each year, we are required by statute to perform certain audits and reviews that cover the two loan programs. These include the financial statement audit of FSA and a review of information security, which includes major systems supporting the loan programs.

While we are still in the planning phases for our fiscal year 2006 Work Plan, some examples of audits in the student loan programs from our fiscal year 2005 Work Plan are:

- A review of the exceptional performer servicing of claims designation in the FFEL program. (Once a lender is designated as exceptional, it received 100 percent reimbursement on defaulted loans.);
- A review of compliance with Foreign School FFEL program Dear Colleague Letters geared to decrease the instances where FFEL borrowers falsely claim attendance at foreign schools and used the FFEL funds for other than their intended purpose; and
- Audits of external entities designed to identify improper payments to participants in the student loan programs, such as payments to guaranty agencies, subsidy payments to lenders, ineligible loans at schools, and ineligible borrowers.

Our current Work Plan also sets out investigations that we anticipate in the student loan programs such as investigations into schools' failure to refund tuition, ineligible locations and programs, falsified FAFSAs, and embezzlement.

IV. OIG Legislative Proposals

In January 2004, we submitted to Congress 20 recommendations for changes we believe are needed in the reauthorization of the HEA. These recommendations are supported by our audit, inspection, and investigative work in the student financial assistance programs. We urge you to consider each of these suggestions. Two of the most significant are to make persons convicted of such fraud no longer eligible to receive student financial aid and to increase the validity of the cohort default rates.

The first provision would serve as a deterrent for fraudulent activity. Persons who have fraudulently received student financial assistance funds should permanently lose their eligibility for any additional such funds. The Health and Human Services and Agriculture statutes have similar provisions for welfare and food stamp defrauders.

Although cohort default rates currently provide the information required under the HEA, they do

not appear to provide decision-makers with sufficient information on defaults in the student loan programs. Our proposal to increase the validity of the cohort default rates would shorten the number of days of delinquency before a loan is declared in default and eliminate borrowers in deferment or forbearance. These suggestions stem from an audit we conducted last year where we found that, under the current definition of cohort default, borrowers who enter repayment during the last two months of a cohort's fiscal year cannot default on their loans before the end of the following year. We also found that if a student receives a deferment or forbearance on a loan during the cohort's fiscal year or the following fiscal year, the student cannot default on the loan before the end of the following fiscal year, even if he or she never makes a payment on the loan.

As I noted earlier, I also want to again encourage Congress to support efforts to amend the Internal Revenue Code to allow the Department to match the information provided on students' applications with the income data that is maintained by the Internal Revenue Service. This action will go a very long way to identifying income inconsistencies and eliminating an area of fraud and abuse within the student financial assistance programs.

In closing, let me reiterate that I believe with the increased support of Congress, we can work with the Department to successfully address areas of risk in the student financial assistance programs, and help reduce waste, fraud and abuse in these important programs.

This concludes my written statement. I am happy to answer any of your questions.

Chairman TOM DAVIS. Thank you both very much.

Let me start, Ms. Shaw, with you. Paraphrasing your written statement, the availability of choice has made both loan programs stronger through competition. It has been the catalyst for innovation, has forced standardization of data exchange and directed focus on service to students, parents and schools.

Can you give us more specifics on the enhanced services to students, parents and schools that you are talking about?

Ms. SHAW. Yes. I mentioned, for example, the fact that we have converted what was a paper process, the Federal application, preapplication for Federal Student Aid, which was 100 percent paper-bound. We have now migrated that to nearly 90 percent electronic via our Web services. Practically every provider out there has Web-based services now under both programs, either the Pell or the Direct Loan. It all begins with the FAFSA form and application process and goes all the way through the back end on the servicing side where you can do online payments, you can do electronic debiting, and basically self-service to borrowers on the back end.

So all throughout the entire life cycle of the borrower's experience with student aid, everything has been migrating toward Web-based services and streamlined processes for everybody.

Chairman TOM DAVIS. I was looking at how much money was being spent on the administration of these student aid programs. These numbers I have gotten from the Department of Education show that prior to the beginning of direct lending, the Department was spending about $120 million on administering student aid programs. Last year it was $720 million, a sixfold increase.

Why has the spending gone up so much? Is it the amount of loans going out? Do you know the reason?

Ms. SHAW. The way, what we do in Federal Student Aid, I try to look at our budget numbers from three aspects. One, our staffing expense; two, what I call our baseline operation, or operating expenses, everything from travel to our equipment, to our contracts for IT and services, and down to other administrative expenses, that being the account maintenance fees, subsidies and contract collection costs.

Yes, things are driven by volume. We have had roughly since 2000 I believe around a 60 percent increase in loans coming into the system that go all the way through the application process, through the various delivery models and mechanisms, either through the Direct Loan process or through the Pell process.

So yes, some of it is volume-based, for sure. We in Federal Student Aid, in particular in the past several years, have been making investments of dollars to modernize our systems, to integrate our different processes and systems together. For example, I mentioned in both my written and verbal testimony, we have two major initiatives underway right now to basically overhaul all our back-end processes, direct loan servicing, direct loan consolidation, our collection processes, into a single solution.

We just launched a new project to do the very same thing on the front end part of our business processes to bring together everything from aid awareness to application processing to Pell Grant delivery, origination and disbursement of those funds under direct

loans as well. Those things require money to make investments, but they also deliver savings over time.

Those two initiatives alone will save taxpayers over a billion and a half dollars over the 10-year terms of those contracts, over what would have been spent, had we not undertaken those initiatives. So some of it is investment. Some of it is driven by volume growth. Some of it is down to us being, staff costs growth, for example, our staff has been reduced over 19 percent, but the costs are higher, even though our staffing is lower. So it is a combination of factors, Mr. Chairman.

Chairman TOM DAVIS. Are there problems with schools reconciling accounts under the Direct Loan Program?

Ms. SHAW. No, in fact, we substantiate disbursement of dollars through our common origination and disbursement system, within 30 days of those funds being delivered at close to 100 percent level.

With that said, when the common original and disbursement system was first rolled out in 2002, there were some typical system roll-out issues that have been worked through. For the most part, I believe that schools are able to use that system to appropriately reconcile their funds. We have put into place systems and processes and internal controls so that, in fact, we do substantiate those funds at nearly 100 percent each month.

Chairman TOM DAVIS. I have been told that several hundred schools have left the Direct Loan Program, since they joined it. Do you know why schools have left it? Is it based on size, location, or type of school, or are there any regulatory barriers. Is this going to cause a problem in sustaining the Direct Loan Program?

Ms. SHAW. The outflow of schools stayed fairly steady around 25 percent. We have around 1,100 schools participating in the program right. Our volume is actually up this year, even though the net school in and out remained relatively constant over the past few years.

Now we deliver $13 billion of loans annually. That was our 2003 delivery. It will be similar this year and maybe slightly higher. I do not see that the number of schools, per say, as it stands right now, is a threat to the viability of the program.

Chairman TOM DAVIS. Has there been a decrease in the number of schools?

Ms. SHAW. Oh, from the inception, yes. We are about 1,100 now. I believe at its peak, it was slightly over 1,300. I believe it was 1,365 in the first and second year of the program.

Chairman TOM DAVIS. OK, thank you.

Mr. Sanders.

Mr. SANDERS. Thank you very much, Mr. Chairman, and thank you very much for holding a hearing on an issue that I think concerns middle class families from one end of this country to the other.

But before we turn to the loan programs that are the subject of this hearing, let me, if I might, speak a little bit outside of the box. That is, to make the point that I think everybody in this room knows, that over the last many years, there has been a significant shift in terms of Federal programs from Direct Grant Programs, such as the Pell Grant, to loan programs.

Mr. Chairman, before we get too much into the nitty-gritty of this or that loan program, I think somebody up here should say that there is something wrong when the United States of America is the only major industrialized country on Earth, which forces its students and its families to pay so much to go to college, and leaves so many people deeply in debt.

In my office right now, there is a young lady who has incurred a $100,000 debt for college. We have several who have gone to law school. It is the same thing.

Now if we are going to be competitive with the rest of the world, if we are going to utilize the intellectual expertise with the capabilities of our young people we want to encourage people to go to college. With an economy in which the middle class is shrinking, people are having a hard time surviving. What we are seeing is a lot of low income and middle income kids saying, gee, I do not want to go to college. I am not going to be able to go to college.

So Mr. Chairman, let me be on the record right now in making a very simple statement. I think the United States of America and this Government have to guarantee the right of every young person in America who has the ability, and not everybody does, who wants to go to college, to be able to go to college, regardless of their income. That is what we should be doing.

We should be moving away from loans and moving back into grants. A government which can provide hundreds of billions of dollars in tax breaks to the wealthiest 2 percent of our population can surely guarantee that every family in America is able to send their kids to college, without going deeply into debt.

Mr. Chairman, my understanding is that of the two main student loan programs that provide essentially the same loans and interest rates to students, one costs American taxpayers billions more every year than the other. The Federal Direct Loan Program is, by any measure, a huge success. It secures loan capital at a lower rate. It eliminates the middlemen, and cuts out billions of unnecessary subsidies to banks.

The other, the Federal Family Education Loan Program, has taxpayers underwrite and subsidize loans issued by private lenders and banks. These loans bear virtually no risk for private banks, yet have an assured rate of return and are guaranteed by the Government.

According to President Bush's 2006 education budget, for every $100 spent on student loans, the U.S. Government pays $12.09 of subsidy on Government-guaranteed private loans. That is over 12 percent of subsidy, and only 84 cents for Direct Loans. I think that is the issue that we are going to have to address today.

Chairman TOM DAVIS. Is that a question to the panel?

Mr. SANDERS. Yes, my question is, what is the debate about when one program costs over $12 to maintain in administrative costs, and one costs 84 cents?

Chairman TOM DAVIS. Does the IG want to hit that today? I know we have a GAO study, looking at those numbers to see if they are accurate.

Mr. SANDERS. This is what the President of the U.S.' people have said.

Mr. HIGGINS. I do not know where those figures came from.

Chairman TOM DAVIS. We will ask IG what he thinks.

Mr. SANDERS. They came from OMB. That is my understanding.

Mr. HIGGINS. OK, I only can tell you that my office, in 1997, tried to make a comparison of the administrative costs between the two programs. Because the Department does not have a cost accounting system, it was very difficult to do that.

We did come up with the conclusion though that the Direct Student Loans administrative cost, back in 1997, was about $17 per loan, while there was a Treasury study that said that with a large bank, it cost $13 a loan to administer. We have done no other work since then on this.

Mr. SANDERS. But do you disagree with the President, in his own education budget, which gives the facts that I have given you?

Mr. HIGGINS. I do not disagree or agree, because I do not know what is behind it.

Mr. SANDERS. I understand that the CBO has come up with a similar conclusion.

Chairman TOM DAVIS. Ms. Shaw, do you have any information on this?

Mr. SANDERS. Ms. Shaw.

Ms. SHAW. No, I agree with the Inspector General. I have not studied the numbers in the President's budget. In fact, what Federal Student Aid does, we operationally administer the programs. My job, in running Federal Student Aid, is to ensure that it operates efficiency for all of the programs we administer, and to reduce costs and manage costs wherever we can, be it the Direct Loan Program, the Pell Grant Program, the FELL Program, Work Study Programs.

So my job is to operationally make Federal Student Aid as efficient as possible. Granted, numbers come from our operation that feed into everybody's studies.

Mr. SANDERS. Mr. Chairman, sorry, I would just conclude by saying that the numbers that I have given come from the President of the United States' 2006 education budget. That is all that I would say.

Chairman TOM DAVIS. Let me say, we have asked GAO to look at this. GAO has hinted in the past that there are some problems and that the numbers were based on assumptions. Nobody has ever checked the assumptions over several years. Now being in operation, we will have a better handle on it when, I think, the report comes back in September, at that point.

Basically, we are trying to look at the efficiencies today. We will just know more about the costs. Maybe, Mr. Sanders, it will be borne out and maybe there will be different numbers when we come back in September. I think our panelists here who work with these really are not prepared to say, either way, because you do not know how to measure that. Mr. Shays.

Mr. SHAYS. Thank you, Mr. Chairman. Mr. Chairman, thank you for having this hearing, and thank you to both our first panel and our second panel. I always appreciate the work of Government officials who are serving our country, and thank you.

I just want to say, I have less trouble with students having debt for graduate school than I do for under-graduate school. I just hired a young man, an under-graduate, who has $90,000 worth of debt.

I would be less concerned about his debt if it were for law school or for medical school and so on.

I also will just say that when I was on the Budget Committee for 10 years, one of the most interesting facts was, as we increased grants to schools, the students did not get them. The schools either raised their tuition, or gave less of a discount to the students. So if they were giving a $3,000 discount or $4,000, they gave $2,000. They said the student had more money and qualified.

So the unintended consequence, frankly, was we were seeing college costs go up significantly, without the students' benefit. I realize that is not really the subject of the hearing. But I just want to put it on the table.

I want to know how the Department of Education recognizes or certifies foreign schools. Is there a list of foreign schools that are pre-qualified? How do you know that they are for real?

I would also say, I have that same issue on online education. I want to know how we know this online education is for real, and whether this is not somewhat of a sham that students get caught up in. I will start with you, Ms. Shaw.

Ms. SHAW. On the foreign school topic, actually working with the Inspector General, they issued a report to us. We bolstered our processes and procedures around that.

We try to do onsite visits, you know, eye ball sites, to see if there is really an institute there, bricks and mortar, if you will. For foreign institutions, we do a variety of other reviews and checkpoints with other Government agencies.

Mr. SHAYS. Does that result in your decertifying a school?

Ms. SHAW. I am sorry, I did not hear the first part.

Chairman TOM DAVIS. Just 1 second.

Mr. SHAYS. Does that result in the decertifying of a school? Has it? I mean, are there cases that you decertified schools?

Ms. SHAW. I do not have that information at my disposal today. I can check on that and get back to you on that in a written format.

If we find out that, for example, when a school is in the application phase, that there is nothing there, and they do not meet the criteria, they are not going to get certified to participate in the programs. If, in a regular review of a school that has been approved to participate in a program, we find that there are issues substantial enough to limit their participation, then we will do that, as well. I can check on the numbers for you, though.

Mr. SHAYS. Yes, if you would provide it to the committee.

Ms. SHAW. Sure.

Ms. SHAYS. You have many applications, so you do a preliminary. But once a school has been approved, do you ever de-certify?

Ms. SHAW. Have we ever decertified schools?

Ms. SHAYS. Yes.

Ms. SHAW. Yes, as a general statement, we do decertify schools. With respect to foreign schools, I do not recall off the top of my head if we have decertified any during my tenure there, but I could double check.

Mr. SHAYS. The question would be, and I do not need an answer now if you do not know, once you have certified a school overseas, do you periodically go back and check?

Ms. SHAW. Oh, yes, we do program reviews and other checks, yes.

Mr. SHAYS. Site visits?

Ms. SHAW. Where appropriate, we do site visits, yes.

Ms. SHAYS. Mr. Higgins, can you respond to these questions?

Mr. HIGGINS. Yes, my office has done a lot of work in the foreign school area. We have done a lot of work in that area, and as a result, we have made some recommendations to Terri's office, which she has implemented. We recommended that the guaranty agencies, before they make a disbursement, they ensure themselves that the student has matriculated at the school.

I also have two recommendations in my testimony to strength that also, where the second disbursement is not until there they know that this student is actually going to school. That is also a recommendation. We also have a recommendation that payment does not go to the student until after the matriculation is confirmed.

Mr. SHAYS. Let me just conclude by saying, I appreciate the Department of Education working with our Inspector General. I think that there is much to be learned from our Inspector Generals in the GAO reports. When we do that, we provide better programs. So thank you for doing that.

Chairman TOM DAVIS. Thank you.

Mr. Van Hollen.

Mr. VAN HOLLEN. Thank you, Mr. Chairman, and I thank you for holding this hearing. I also serve on the Education Work Force Committee, so I am pleased that Government Reform is also looking into this issue.

I think we would all agree that we want to make sure that Federal taxpayers' dollars go as far as possible in providing our students with help in the form of grants and loans in their education.

In that connection, I would like just to talk about the 9½ percent loans. You are familiar with that issue, I assume. Is that right?

Ms. SHAW. Yes.

Mr. VAN HOLLEN. For the benefit of the committee, these are loans that are essentially guaranteed return for the lender at 9½ percent. There are a number of lenders that are still taking advantage of this program. Last year, the Congress passed an amendment. It was a 1-year legislation that addressed a part of the issue. But it did not deal with the whole issue. We still allow recycling of these 9½ percent loans.

The Congressional Budget Office has made it clear that if we close this loophole, we would save the taxpayer over $1 billion over 5 years. Mr. Chairman, you referenced GAO reports. The GAO looked at this and made it clear that we could have substantial savings to the Education program if we closed this loophole. My question is very simple. Does the Department of Education support closing the 9½ percent loan loophole?

Ms. SHAW. I believe the Department of Education does.

Mr. VAN HOLLEN. In its entirety?

Ms. SHAW. To the best of my knowledge. The question might be better answered by the Office of Post-Secondary Education. The Department supported the recent amendment, the Cunningham amendment, that closed it. I know there is more work to be done.

I have read all the materials, and to the best of my knowledge, yes. We monitor the billings on a quarterly basis by all lenders in the program. We are watching it very closely.

Mr. VAN HOLLEN. All right, well, Mr. Chairman, I would hope that we could take a position as a committee on a bi-partisan basis, that we should shut down this subsidy. There is no point in continuing the recycling of these funds.

Let me ask you a question with respect to the other loan programs. I agree with the chairman, that it is important to have a healthy competition between the FFELP Program and the Direct Loan Program. However, there is a provision in law that essentially prohibits the FFELP Program participants from offering inducements to colleges and universities to switch. In other words, using special incentives and, for example, promises to pay private loans to students who otherwise would not qualify. Are you familiar with those provisions?

In fact, I believe it was in 2003 the Inspector General's Office did a study of this issue. We have a memo here, Mr. Chairman, that I would like to submit for the record on that issue, where you looked into that question, and made a recommendation that the Department clarify its guidelines on that issue.

You specifically looked at a situation where Sallie Mae had negotiated a deal with Pace University. You looked into the different facts and concluded that this was an area that needed further clarification and made a recommendation to that effect. Do you know whether the Department followed the recommendations of the IG in that regard?

Mr. HIGGINS. No, I do not know whether they did or not.

Mr. VAN HOLLEN. Were you at the Department at the time?

Mr. HIGGINS. Yes, I was.

Mr. VAN HOLLEN. Is there any mechanism for followup here? I mean, there have been a number of serious issues in connection with this. I am just wondering whether the Department took any action following your recommendations?

Mr. HIGGINS. I do not know. I can check on it and get back to you for the record, if you want me to.

Mr. VAN HOLLEN. If you could, I mean, you would agree, would you not, that the law prohibits this kind of inducement to switch programs?

Mr. HIGGINS. On the part of—yes. What we also found was that colleges and universities were out there soliciting incentives. So we found the opposite of what the law was prohibiting. The players switched places.

Mr. VAN HOLLEN. All right. I just would ask, in your capacity as Inspector General, that you let Members of Congress know if the Department is now following through on your recommendations. I appreciate getting some feedback on that. I would hope that the Department, if it has not taken action, would do so quickly.

Thank you, Mr. Chairman.

Chairman TOM DAVIS. OK, thank you, I think what we will do at this point is recess and be back in about 15 minutes, if you can hang around for some additional questions, thank you.

[Recess.]

Chairman TOM DAVIS. Ms. Shaw, I'll just start while waiting for other Members to come back. My understanding is that most of the money for administering student aid programs is money that is provided in an entitlement account.

Ms. SHAW. I am sorry, I could not hear you.

Chairman TOM DAVIS. Most of the money is from entitlement accounts that administer student aid programs. Is that right?

Ms. SHAW. From the 458 account, if that is what you are referring to?

Chairman TOM DAVIS. Yes.

Ms. SHAW. Yes.

Chairman TOM DAVIS. So the salaries and expenses are considered entitlement spending. In other words, whatever it is, it is, and it is paid for, and if the President's budget makes a change in that, to move it to appropriated funds. In other words, you have a ceiling under appropriated funds, entitlement funds. The cost is what it is, and it is paid for out of the program. Is that correct?

Ms. SHAW. Mr. Chairman, I am not the budget expert in all of the funding and the movement of funds behind the scenes. I can find out the answers.

Chairman TOM DAVIS. Here is my understanding. It is mandatory. Do you know the answer to that, Mr. Higgins?

Mr. HIGGINS. I think you are right.

Chairman TOM DAVIS. OK, and my understanding is that mandatory administrative money is like a slush fund. I mean, if you do not spend it in 1 year, you roll it over and you can spend it in the next. Is there oversight on these expenditures, do you know, Ms. Shaw and Mr. Higgins?

Ms. SHAW. Oversight on the expenditures and money that is used 1 year?

Chairman TOM DAVIS. No, in the entitlement fund.

Ms. SHAW. Mr. Chairman, I am not the budget expert.

Chairman TOM DAVIS. OK.

Ms. SHAW. We certainly manage the money that we use in Federal student aid to deliver aid to students. We run our operation more like a business that you would find in the private sector. I look at the operating expense, much like a business would. The budget services group within the Department of Education does all the budget wizardry behind the scenes.

But with that said, we clearly monitor and oversee all spending from the Federal Student Aid Office. In fact, we talk about it regularly. We have a regular budget meeting in my office to examine every spend out of our office.

Chairman TOM DAVIS. From your testimony, I understand that FSA contracts with an estimated 6,000 contract staff. Is that about right?

Ms. SHAW. Yes, we have about a half a billion dollars in outsourced agreements with the various providers that do our business functions under our monitoring.

Chairman TOM DAVIS. In Inspector General Higgins' written testimony, he referred to two audits that found FSA lacked oversight of contract deliverables, and did not ensure a continuation of service and adequate audit access to the systems.

Ms. SHAW. Yes, he did.

Chairman TOM DAVIS. The interface problems between systems has caused some problems. Can you comment on what you are doing to correct this?

Ms. SHAW. What we have done, the specific audit you are referring to, our contracts, one of them was our common origination and disbursement system. That particular contract, which is nearing completion at the end of 2006 was a share and savings contract. That contract was atypical in that regard.

What we have done with all of our contracts is, we have bolstered our contracts and acquisitions management team, including pricing experts and the Federal acquisition regulation experts. We do regular contract reviews. We work very closely with the Office of the Chief Financial Officer in the department and the Chief Acquisition Officer within the department, to make sure that we are totally in compliance with all rules and regulations.

With that said, we also, within Federal Student Aid, have Federal staff closely monitoring all agreements at this point. I think the Inspector General, in some of his prior year findings, was probably accurate that we could be better in that regard, and I believe we put in new process and procedure and focus on that. I believe that we are better.

Chairman TOM DAVIS. Mr. Higgins, let me ask you, how much money does the Student Loan Program lose to waste, fraud, and abuse annually, and what is the main cause?

Mr. HIGGINS. We do not have that figure. We do know that the department reported in the PELL grant program improper payments of $365 million in 2003. Then there was $131 million of audit and program liabilities that they also reported. But we do not know what that figure is.

Chairman TOM DAVIS. What is the collection ratio on loans from the Direct Lending Program, have there been any problems with that?

Ms. SHAW. I am sorry?

Chairman TOM DAVIS. The collection, in terms of being able to collect on the loans under the direct lending program.

Ms. SHAW. No, actually, under the Direct Loan Program, we are in possession of all of the data with respect to each loan. Actually, it is a little easier for us, because we have all of that data. When loans are subrogated to us for collection from the Pell Program, we do not necessarily have the depth and breath of data that we have on the Direct Loan Program, because have originated a direct loan.

Chairman TOM DAVIS. But my question is, how are you collecting it? Are there any problems?

Ms. SHAW. No.

Chairman TOM DAVIS. You are doing just great.

Ms. SHAW. Well, we certainly are doing better than we ever have. We contract out our services to around 13, I believe, private collection agencies. They compete with each other, with respect to collections.

Chairman TOM DAVIS. Is that a share and savings contract, or is that on an hourly basis?

Ms. SHAW. No, it is not a share and savings contract. They earn based on their performance, which is different than a share and savings contract. So those collection agencies are doing quite well,

and that incentivized process that we have and the contracts that we have in place have bolstered our collections across the direct loan portfolio.

Chairman TOM DAVIS. How much money do you lose annually, in direct lending, on loans that are uncollected?

Ms. SHAW. I do not know the answer to that question. I will have to get back to you on that.

Chairman TOM DAVIS. Obviously, you lose whatever you pay out to the private sector to collect. That is a loss, right?

Ms. SHAW. Right, but for every dollar we spend in collections, I believe we recover another $7 or $8.

Chairman TOM DAVIS. Right, so my question is, what does it cost you annually, as you outsource this to other areas in the amounts uncollected, do you know?

Ms. SHAW. We spend, I believe, in the area of $200 million to $250 million a year in private collection costs. I believe it was last year that we recovered, on our portfolio, meaning the $17 billion portfolio, about $1½ billion.

Chairman TOM DAVIS. You do not know how much just never gets collected, even after you outsource the collections, right?

Ms. SHAW. No, I could get that figure for you. I do not have it.

Chairman TOM DAVIS. It may not be important, but it is at least a quarter of a million you are paying to collect it, and then on top of that. I do not know if the GAO has that. I think if you are really comparing the two, you need to understand, on one side, you are eating up the cost of collecting the loans. On the other side, the taxpayers are paying that. That has to be part of the equation.

Because we get a lot of numbers thrown around here, in terms of this being more efficient than the others, the estimates, and nobody really knows what the numbers are. Even if you give me that, that gives me a piece of the pie. But I think that would be interesting.

Ms. SHAW. I can get that for you.

Chairman TOM DAVIS. Mr. Higgins, first, I want to commend you on your efforts to analyze patterns of fraud and abuse in the Student Financial Assistance Programs, and you are reaching out to the FSA staff to coordinate those efforts.

One of the areas you mentioned in your written testimony involves FAFSA, the Free Application for Federal Student Aid. You estimate that under-reporting of income on these applications resulted in $365 million over-awards in Pell Grants in 2003, which was up from previous years, and state that the Department has not estimated the effect of mis-reporting of income on Student Loan Programs.

How might they better contain this? I mean, I have filled out a FAFSA loan, too. I am like many parents, suffering from "mal-tuition." [Laughter.]

You know, you kind of take their word for it when they fill out the loan.

Mr. HIGGINS. Well, there are not a lot of matches made around eligibility. But we think the most effective match would be the IRS match. The authority for that was given to the Department of Education. But Treasury has not been given the authority to perform

this match with us. All we are looking to do is confirm the income that is reported to us.

Chairman TOM DAVIS. That makes sense. That is not your fault. That is Treasury's fault for not giving you the numbers so you can cross-reference everything. Is that correct?

Ms. SHAW. Right, we cannot do a match with them right now, as we would like to do.

Chairman TOM DAVIS. That is probably the easiest way to find out if these numbers are accurate. That is something that the committee can look at, since we have a piece of jurisdiction on that. That is all for right now. I am going to ask Mr. Clay if he has any questions.

Mr. CLAY. Thank you, Mr. Chairman.

Let me start with Mr. Higgins. Your office has looked into waste and abuse in federally funded loan guaranty agencies, such as USA Funds and PHEAA. One concern that the IG has expressed is the existence of conflicts of interest on the part of guaranty agencies.

In 1993, the IG found that many of the guaranty agencies that they investigated were affiliated with loan service providers that they are required to monitor. The IG concluded that billions of dollars of the Nation's guaranty loan portfolio are at risk because many guaranty agencies have a clear conflict of interest.

I am curious about the current status of these conflicts of interest. Has your office continued to monitor guaranty agencies for the existence of conflicts of interest, or are there still problems in this area?

Mr. HIGGINS. That audit, initially, the Department sustained our finding in that audit, and it was overturned in appeal. The Department thought that because the sub that we were talking about had its own tax identification number, there was enough separation and it was not a conflict of interest. I think that is the report you are speaking to.

Mr. CLAY. Yes, I still encourage you to vigilantly monitor the issue. Conflicts of interest are a problem that could potentially cost the taxpayers millions of dollars.

In 2003, you audited 9 of the 35 guaranty agencies and identified $164 million in waste and abuse. For instance, at one agency alone, you received over $100 million in excess Federal funds that the Department of Education did not even know it had overpaid. Your findings regarding the nine agencies audited suggest that a comprehensive audit of the guaranty agency might find significant additional waste and abuse. Since 2003, have you audited additional guaranty agencies?

Mr. HIGGINS. No, we have not looked at more than the original nine. But we did recommend to the Department that they look at the additional guaranty agencies.

Mr. CLAY. Have you conducted followup audits of those original nine?

Mr. HIGGINS. We are monitoring the status of the resolution of the nine audits. All those nine have not been resolved. To my knowledge, they have not done the followup audits as far as the split on the Federal expense account.

Mr. CLAY. Are they part of your work plan for this year?

Mr. HIGGINS. Part of Ms. Shaw's work plan or my work plan?

Mr. CLAY. Ms. Shaw's.

Ms. SHAW. We have a work plan to do program reviews and audits of schools, lenders, and guaranty agencies, the servicers that participate in the programs. Yes, we are focusing in on the guaranty agencies, and our oversight of them, and doing onsite reviews.

I do not recall off the top of my head the specific nine that you are referencing. But yes, we do have plans for not only this year, but in 2006 to do onsite reviews at guaranty agencies, as well as other participants in the program.

Mr. CLAY. Well, I would hope so. Because the fact that you uncovered $164 million in abuse in an audit of only a quarter of the guaranty agencies suggests to me that it would be worthwhile to take a deeper look.

Ms. SHAW. Certainly.

Mr. CLAY. Mr. Chairman, that is all that I have for now.

Chairman TOM DAVIS. Well, thank you very much. I know Mr. Kucinich wanted to ask questions, but he is not here. So we will move on to the next panel. I want to thank you both. Particularly after the GAO audit is out, we may want to get you back here. But we will coordinate that with the Education and Workforce Committee on that. Thank you very much.

Ms. SHAW. Thank you.

Chairman TOM DAVIS. We will take a 2-minute recess before we call our next panel.

[Recess.]

Chairman TOM DAVIS. This is a distinguished panel, and I want to thank them all for coming to Washington today and sharing their wealth of experience. We have Dr. Allen Merten, who is the president of George Mason University. We have Ms. Sarah Bauder, who is the director of student financial aid at the University of Maryland.

We have Nancy Coolidge, the coordinator of Federal student financial support, Office of the President, University of California, who was already introduced by Mr. Waxman. We have Natala Hart, who will be back in a minute, and Cynthia Thornton, the director of student financial aid at Dillard University.

Let me just say, we are happy to have all of you here, and Dr. Merten, particularly, I am happy to have you here. We are just proud of the job you are doing at George Mason. I am really pleased that you are in my district.

I am very proud of the fact that George Mason has two Nobel Prize winners now. I will just let everybody know that. It heads up a lot of the very basic research in a number of areas, from computer science to brain surgery. We are just very happy to have you here.

It is our policy that we swear everyone before you testify. So let me start with you, and I will get Ms. Hart when she comes in. If you will just raise your right hands.

[Witnesses sworn.]

Chairman TOM DAVIS. Dr. Merten, we will start with you. Thank you for your patience, and just again, we are very happy to have you here today.

STATEMENTS OF ALAN MERTEN, PRESIDENT, GEORGE MASON UNIVERSITY; SARAH BAUDER, DIRECTOR OF STUDENT FINANCIAL AID, UNIVERSITY OF MARYLAND; NANCY COOLIDGE, COORDINATOR, FEDERAL STUDENT FINANCIAL SUPPORT, OFFICE OF THE PRESIDENT, UNIVERSITY OF CALIFORNIA; NATALA HART, DIRECTOR OF STUDENT FINANCIAL AID, OHIO STATE UNIVERSITY; AND CYNTHIA THORNTON, DIRECTOR OF STUDENT FINANCIAL AID, DILLARD UNIVERSITY

STATEMENT OF ALAN MERTEN

Mr. MERTEN. Thank you, Mr. Chairman.

With approximately 29,000 students, George Mason is the largest university in Virginia. As a State university, our mission is to provide excellent educational opportunities to our students, while maintaining high quality and affordable access. Twenty-five percent of our freshman are first in their families to attend college.

George Mason has had experience with both the FFELP and the Federal Direct Loan Program. Therefore, I feel we have a unique viewpoint to share, since we left FFELP to become a direct lending school in 1995, and returned to FFELP in 2004.

The Federal loan programs are critical to our ability to provide affordable access to higher education. Approximately one-third of our students benefit from the Federal loan programs. Federal loan programs constitute $60 million of the overall $99 million in aid awarded to our students last year, which is consistent with the national average of 59 percent.

George Mason has a $500 million annual budget, of which $141 million comes from tuition revenue, so Federal loans account for over 40 percent of our tuition revenue.

Approximately 3,500 of our students receive a Federal Pell Grant, while over 10,000 receive some type of Federal loan. George Mason's Federal loan borrowing has increased by over 5 percent in the last 5 years. Sixty percent of our financial aid applicants are from families with income of less than $50,000.

The university takes pride in the sense of responsibility that our students have demonstrated. Mason's overall cohort default rate is very low. It is 2 percent, which is less than one-half of the national average of 5.2 percent. In addition, our Office of Student Financial Aid has received a Model of Quality Award from the Department of Education.

In the 1995 and 1996 academic year, George Mason joined 1,200 other institutions to become a direct lending school. The major viable that made direct lending the obvious choice for us was the inefficiency of FFELP at that time.

Under FFELP, our students were borrowing from hundreds of different lenders and guaranty agencies. Although we had electronic funds transfer with the Virginia lenders, all of the other lenders used paper checks. Because of multiple loan servicers, the efforts and costs investigating loan status or even determining whether a check had been delivered was very high. This processing was time consuming and frustrating for our students.

At that time, direct lending eliminated most of the paper processing. All direct loan funds were electronically released to George

Mason, and the Aid Office was able to respond quickly to students' requests. This was a major improvement at that time over FFELP. However, over the 8 years that we were a direct lending school, many changes occurred in FFELP.

The FFELP community increased the efficiencies of Federal loan funds delivery. Schools now can easily work with multiple lenders and even multiple guaranty agencies, and still deliver Federal loan funds in a timely manner to our students.

Technological improvements and data systems, spearheaded by the Department of Education, were paramount in creating a more streamlined electronic processing of Federal aid funds.

Mason again began a cross-campus review of its participation in direct lending in 1999/2000. Much of this review was initiated because many of our students and parents wanted to borrow from private lenders. There was an increasing number of complaints about the level of customer service received from the Direct Program.

Private lending institutions also offered other incentives and borrower benefits that the direct loan program did not equal. While direct loans did offer an up-front loan rebate in anticipation of future timely payments, that single benefit did not come close to the other borrower benefits.

Students and their parents increasingly could receive reduced origination fees and reduced interest rates from the private lenders, after they began their loan repayment.

Effective with the 2004/2205 academic year, we left the direct program and returned to FFELP. We now have one point of contact at both the guaranty agency and the servicing center to address any systems issues.

Our students and parents who are Federal loan borrowers are happy with the changes and benefits that have become available because of our return to FFELP. They much appreciate the fact that they are given a choice in lending institutions. The benefits to our students and parents were the deciding factor in choosing to utilize direct lenders.

There continues to be new benefits to our students from FFELP in addition to the Federal loan repayment/discharge options. For example, effective next academic year, in Virginia, the newly established Teach for Virginia and Care for Virginia loan programs will grant added benefits to teachers and nurses who stay in Virginia.

The competition among private lenders has provided savings and other benefits to parents and students that direct lending cannot match. Improvements in processing loans through the FFELP system have decreased the administrative burdens that existed in the 1990's.

Finally, while we are excited about providing options to our students and parents, the sources of money have become increasingly limited when it comes to assisting students in financing their postsecondary education.

We rely heavily on the State and Federal Government financial aid funds. The reductions in the Federal Campus Based Programs and the elimination of the Federal Perkins Loan Program are of great concern to us. Our country's college student population is going to increase, and so are the overall costs of education.

We encourage you to do all that you can to provide programs and funds that encourage our youth to learn through the dream of higher education, thank you.

[The prepared statement of Mr. Merten follows:]

Thursday, May 26, 2005
Committee on Government Reform
Federal Student Loan Programs

TESTIMONY OF DR. ALAN G. MERTEN
PRESIDENT, GEORGE MASON UNIVERSITY

Good morning. I am Alan G. Merten, President of George Mason University. George Mason University is a four-year public institution located in Northern Virginia. George Mason has gained national distinction in a range of academic fields, including public policy, information technology, economics, the fine and performing arts, law, conflict resolution, and the biosciences.

With approximately 29,000 students, Mason is the largest state university in Virginia. Our students are studying in 149 degree programs at the undergraduate, graduate, and professional levels. As a state institution, our mission is to provide excellent educational opportunities to our students, while maintaining high quality and affordable access. Twenty-five percent of freshmen are the first in their families to attend college.

Universities currently have a choice between two processes for facilitating federal lending to students and their parents. Under the Federal Family Education Loan Program (FFELP), families choose the financial institution from which they borrow. In contrast, under the Federal Direct Loan Program, funds are transferred directly from the Direct Loan Servicing Center to the university. Mason has experience with both processes. Therefore, I feel we have a unique viewpoint to

share since we left FFELP to become a Direct Lending school in 1995 and returned to FFELP in 2004.

The federal student and parent loan programs are critical to our ability to provide affordable access to higher education. Approximately one-third of our students benefit from the federal student and parent loan programs. The federal loan programs constituted $60 million of the overall $99 million aid awarded to our students this year, which is consistent with the national average of 59%. George Mason has a $500 million annual operating budget, of which $141 million comes from tuition revenue, so federal loans account for over 40% of tuition revenue.

At Mason, approximately 3,500 students receive a Federal Pell Grant, while over 10,000 students receive some type of federal loan. Federal loan borrowing at Mason has increased 50% in the last five years from $40 to $60 million a year. While part of this increase is due to our growing student population, the increase also reflects an increase in need among our students. Sixty percent of our financial aid applicants are from families with incomes of less than $50,000.

The university takes pride in the sense of responsibility our students have demonstrated. Mason's cohort default rate (percentage of students that do not repay) is very low -- 2% for FY 2002 which is less than half of the national average of 5.2 percent. In addition, our Office of Student Financial Aid has received a Model of Quality award from the Quality Assurance program of the U.S. Department of Education.

Federal Family Education Programs and Federal Direct Lending

In the 1995-1996 academic year, Mason joined about 1,200 other institutions to become a "Direct Lending" school. This decision was made after an extensive review of this new lending option for our loan borrowers. Our participation in the U.S. Department of Education's Quality Assurance Program gave us an added edge since we were already accustomed to reviewing processes.

The major variable that made the change to Direct Lending an obvious choice for us was the inefficiency of the FFELP process at that time. Under FFELP, our students were borrowing from hundreds of different lenders and guarantee agencies, and although we had electronic funds transfer (EFT) with the Virginia lenders, all of the other lenders used paper checks, mailed to the Student Accounts office. Student Accounts would have to contact the student, and then the student had to go to their office to endorse the check before the student would receive the funds toward their tuition charges. When the loan funds were for the parent, checks were mailed to parents for endorsement, who then had to return the checks to Mason. Because of multiple loan servicers, the effort and cost spent investigating loan status or even determining where a check had been delivered was very high. This processing was time consuming and frustrating for students who were in dire need of the funds.

Direct Lending eliminated most of the paper processing. All direct loan funds were electronically released to Mason, and the aid office was able to respond quickly to students' requests for the status of their loans. This was a major improvement over FFELP. However, over the eight years that we were a direct

lending school, many changes occurred in the FFELP banking community, which made the banks more competitive.

The FFELP community was also involved in increasing the efficiency of federal loan funds delivery. Schools can now easily work with multiple lenders and even multiple guarantee agencies and still deliver federal loan funds in a timely manner to their students. Additionally, technological improvements and data systems, spearheaded by the efforts of the Department of Education was paramount in creating a more streamlined electronic processing of federal aid funds.

Mason again began a cross campus review of its participation in direct lending in 1999/2000. We utilized students, parents, University Life staff and Enrollment Services offices to again review our loan program and to determine if we should remain with Direct Lending. Much of this review was initiated because many of our students and parents wanted to borrow from private lenders, and there were also increasing complaints about the level of customer service received from the Direct Loan Servicing Center. Private lending institutions also offered other incentives and borrower benefits that the direct loan program could not equal. While Direct Loans did offer an up front loan fee rebate in anticipation of future timely payments, that single benefit did not come close to some of the borrower benefits that were being offered through private lenders.

Students and their parents increasingly could receive reduced origination fees and reduced interest rates from the private lenders after they began their loan repayment. For example, Mason has a large number of Navy personnel and their families, who are members of Navy Federal Credit Union, which offers 1%-2% fee

reductions on the front and back end of loan processing for its members. These benefits are not available through the direct lending program.

At the same time, the issues that drove our move to direct lending in 1994 were becoming less important, or had been resolved by the FFELP community. The issue about the paper processing of checks is still a concern, but otherwise, the differences in the two loan programs did not offer an overwhelming reason to remain a direct lending school. Additionally, FFELP had a larger customer service area, more default aversion options and web-based servicing access available to the school as well as the borrower.

Effective with the 2004-2005 academic year, we left the Direct Loan program and returned to FFELP. The guarantor and the servicing center worked closely with our financial aid office to ensure a smooth transition back to FFELP. Like our previous arrangement with the Direct Lending Loan Servicing Center, we have one point of contact at both the guarantee agency and the servicing center to address any system issues. Our aid office has the electronic access to view and resolve any issues with the servicer, and FFELP allows for more staff members to gain access to the student loan information which was previously limited to only a few staff members in the direct loan environment.

Our students and parents who are federal loan borrowers are happy with the changes and benefits that have become available because of our return to FFELP. They much appreciate the fact that they are given a choice in lending institutions. Although it would still be administratively easier to have one servicer, the benefits to our students and parents were the deciding factor in choosing to utilize private lenders over the ease of processing of direct lending for our financial aid staff.

There continues to be new benefits to our students from FFELP in addition to the federal loan repayment/discharge options. For example, effective the 2005-2006 academic year, through the work of Governor Warner, the Virginia General Assembly, NellieMae and SallieMae, the newly established "Teach for Virginia" and "Care for Virginia" loan programs will grant added benefits to teachers and nurses who stay in Virginia and are employed in the nursing or teaching professions. The students will be granted a 10% cash back in addition to any other borrower benefits they have been granted after making 36 regular payments on their federal student loans. These programs have confirmed our decision to return to FFELP.

Conclusion

The competition among the private lenders has provided savings and other benefits to parents and students that Direct Lending cannot match. Improvements in processing loans through the FFELP system have decreased the administrative burden that existed in the 1990's. We believe that the overall benefit to families justifies the remaining additional administrative costs of having more than one servicer under FFELP.

Finally, while we are excited about providing options to our students and parents, the sources of money have become increasingly limited when it comes to assisting students in financing their post-secondary education. We rely heavily on the state and federal government financial aid funds. The reductions in the Federal Campus Based Programs and the elimination of the Federal Perkins Loan Program are of great concern to us as they relate to the options that students will have in the future. Our country's college student population is going to increase, and so the overall

costs of education. As more and more students are entering post-secondary education, the idea that available funds are dwindling for our students is very troubling. As it is, our students have been limited in what is available to them and we have seen a 10% increase, in the last year alone, of students having to take out private educational loans in addition to their federal loans. I encourage you to do all you can to provide programs and funding that encourages our youth to live the dream of higher education – for their good and the good of our future.

Chairman TOM DAVIS. Thank you very much, Dr. Merten.

Ms. Bauder, thanks for being with us.

STATEMENT OF SARAH BAUDER

Ms. BAUDER. Mr. Chairman, I want to thank you for inviting me to speak here today on why the University of Maryland has chosen the FFELP program. My name is Sarah Bauder, and I am the director of financial aid at the University of Maryland.

In the 15 years I have been in higher education, I have noticed an evolutionary change in the loan industry, most notably when direct lending was introduced in 1994.

If we step back and look at the Higher Education Act and its fundamental purposes, we will notice that it is there to ensure access, affordability, and choice. FFELP and direct lending both offer access and affordability. FFELP is the only one that offers choice, and that is why we have chosen it. We have different lending options.

The University of Maryland is home to 24,000 undergraduate students and 9,000 graduate students. We process approximately $90,000 million in Federal student loans for 19,000 students. We have 28 different staff guidance counselors that can work with our students. Over the years, we have built great partnerships with our lending institutions.

Our lenders provide many value-added services to our students that I do not think can be underscored enough. We basically can offer a zero fee loan to our students. So a student who borrows $5,000 actually receives $5,000.

Our lenders provide flexible repayment options on the back end. They provide delinquent and default initiatives for our students and financial management awareness. They provide training and workshops for our staff, so that we have education all around. We fully understand that the University of Maryland is not only for educating within the classroom, but we have to educate outside the classroom, as well.

Our default rate is 1.4 percent, which is significant. The lenders know that we are a low risk, and so our students are going to pay back their loans when they lend to our students. That is because we communicate with them, and they have a personal relationship with their lender.

Lenders also provide scholarships, and I do not think that has been mentioned. That helps defer the cost of students attending college and also from borrowing.

Now the University of Maryland, our culture is really one of research and development. So over the years, we have been able to enhance our technologies. We have a fully paperless loan process. That is significant, because we have been able to cost save on mailing and on communications to our students. That cost savings then can be reallocated into other educational benefit for our students. The only way that we could have done that is to build partnerships with our lenders.

We do not have the administrative burden of reconciliation. Our lenders do that on a daily basis. So once again, we have cost savings on the administrative side.

I think the advent of technology has definitely helped us. I think that has been brought out today. If we look at the legislation of the Higher Education Act, it recognizes the need for Federal support of higher education today, as well as equal access. That commitment holds true.

What I have seen in higher education is that the attitudes of families have shifted over the few 15 years that I have been there. It used to be that higher education was really a privilege, to get an undergraduate degree. Now it is considered a right.

So financing in education is extremely important, and parents and students really do trust the financial aid office and the information that we give them. We hold that responsibility sacred. We want to make sure we are giving them the best financial information that we can give them, and the best options and the best choices.

I applaud direct lending. I was there when direct lending was introduced. It really did create a wonderful atmosphere of competition and effectiveness. It woke up the FFELP industry and the lenders to say, hey, we have to improve here.

But choice is essential. The Higher Education Act gives students the option of choosing a lender. If you have only one program, you eliminate that choice.

There are two things I will say in closing here. One, I think if you ever get an opportunity to really visit a university and sit just 1 day in a financial aid office, I think it is really enlightening. I do think reauthorization would happen if you could spend time there in a university. I do think that we need to increase loan limits. We need to increase Pell appropriations for our needy students.

In closing, students and parents finance a new car, they finance a home equity loan. They comparison shop for credit cards. I think they also need the choice when it comes to student loans, as well, thank you.

[The prepared statement of Ms. Bauder follows:]

0102 Lee Building
College Park, Maryland 20742-5145
301.314.9000 TEL 301.314.9587 FAX

Statement on the Performance of the
Federal Family Educational Loan Program (FFELP)

Sarah Bauder, Director of Financial Aid
University of Maryland, College Park

Before the Committee on Government Reform
U.S. House of Representatives
May 26, 2005

Mr. Chairman and Members of the Committee, it is a distinct honor to speak to you about the Federal Family Educational Loan Program, otherwise known as FFELP. My name is Sarah Bauder and I am the Director of Financial Aid at the University of Maryland, College Park. I am thankful for the opportunity to address what I consider to be one of the most important decisions a family will make when attending college, that being how to finance an education.

The fundamental purpose of the Higher Education Act is to ensure access, affordability, and choice. Each one is equally important. If we eliminate one, we lose our balance. I have witnessed the evolutionary change of the loan industry over the last 15 years, most notably when Direct Lending was introduced in 1994. While Direct Lending and FFELP both offer access and affordability, only FFELP offers choice, by providing a variety of lending options to the consumer.

The University of Maryland is home to over 24,000 undergraduate students and 9,000 graduate students. We process approximately 19,000 federal student loans totaling over 90 million dollars in volume each academic year. We pride ourselves on our mission of diversity, especially within our student body. As part of that mission we strive for diversity in every aspect of college life. We understand that financial aid is not a one-size-fits-all program. We know when the word "loan" is mentioned, some students conjure up images of a creditor banging on a door, while others will smile at the gift. We recognize that it is our job to educate, inside and outside the classroom. We employ 28 full time staff to guide students into making the best financial decision possible based on each individual's family financial circumstance. The FFELP program affords us that opportunity by offering a variety of lending options with competitive lending fees and flexible repayment terms, and value added services.

Over the last few years, there has been a great deal of discussion over the rising debt levels of today's student loan borrowers and subsequently, their ability to pay back these loans. Lower interest rates, longer repayment terms, fixed versus variable rates can all make a difference in how much a family will borrow. The Higher Education Act states that borrowers have the

right to choose their lender. The FFELP program gives the parents and students at the University of Maryland this flexibility. Through FFELP, we can provide a wider range of funding options for our students and their families.

We have built long lasting relationships with our lending partners, all of whom provide the best customer service and technical solutions for our students. Through comprehensive research and collaboration, we are able to provide zero fee loans to our students. That means a student who borrows $5,000 dollars actually receives $5,000 dollars with no fees attached. Our lenders provide flexible repayment options and will work with us when we have a student with an unusual circumstance. They provide default prevention initiatives for our students and workshops for our staff as well as communicate directly with our office to keep students out of delinquent status. Because of these initiatives, our cohort default rate is 1.4% and continues to drop. Lenders also provide scholarships and research grants, which help offset the need to borrow.

The University of Maryland's culture is one of research and development. We thrive on new technologies and exploring options. Moreover, we have a fiscal responsibility to the State, the Federal Government, our students and parents. Choice impacts all of them and all must be considered in our institutional decisions. With the advent of technology, we have the flexibility of developing a streamlined, seamless and totally electronic loan process for our students, thereby, cutting costs. Furthermore, we do not have the administrative burden of reconciliation since our lenders reconcile on a daily basis.

The historic legislation of the Higher Education Act recognized the need for federal support of higher education institutions as well as the need for equal access. That commitment holds true today. However, the attitude of families has shifted from accepting higher education as a privilege to believing it to be a right. Financing an education is one of the most important decisions a family can make. Parents and students trust that the institution is working in their best interest. We take this responsibility seriously.

In summary, every day consumers finance the purchase of a new home or a new car, and they comparison shop to select which credit card to use. These choices are based on a free enterprise market that provides healthy competition. We believe that the key to a comprehensive, well-executed financial plan is to provide options. Having only one loan program eliminates choice. We cannot lose the balance of access, affordability, and choice. Financial aid becomes a less effectual program if we take away choice.

I thank you for your attention and for providing this opportunity to describe just some of the benefits of the Federal Family Educational Loan Program.

Sarah Bauder

Chairman TOM DAVIS. Thank you very much.

Ms. Coolidge, your entire statement is in the record.

STATEMENT OF NANCY COOLIDGE

Ms. COOLIDGE. I can assure you I am not going to read the whole thing. I think that it is excellent that you are having this hearing today, and I thank you for doing it.

I represent 200,000 students, almost half of whom get financial aid from the Federal sources, and quite a number of those also get Federal student loans. I am also representing 10 campuses, with lots of financial aid administrative professionals on them, who send their messages through us. We are a central administrative office.

I want to just say that there are three principles that the University of California observes. I can stipulate today, we are not here, and I do not think anybody is here actually, to argue for one program, that one program should win and the other program should go away. In fact, the comments we have to make today have to do with improving the choice between programs, so that schools have equal level playing fields from which to choose.

The core mission of this loan program is a social mission. It is to make it possible for low income students to attend college. To the extent that we can devote resources to that activity, we should do so.

What I am going to focus on today is what we consider at our institutions with six in direct lending, four in the FFELP Program, to be non-level playing fields for the two kinds of programs, and why administrators struggle.

It has built into them some differences, some fundamental differences. At the moment, the playing field is not level. The schools that are in the FFELP Program have available a feature, and in my institutions it matters, because we have lots of graduate and professional students who would quality.

There is a provision called the School as Lender. This is used, and we are under a fair amount of pressure, to think of using it. We are not at the moment, but certainly we are being asked to do feasibility studies and look at it, to bleed out Federal subsidy out of the FFELP Program for uses by students, and in this case it could be by low income students certainly, or to give the borrowers even better loans than they are getting right now.

So the School as Lender would allow a school to become a lender and to share the profits of doing so with a recognized lender/partner.

There is no equivalent to that in the direct loan program. Frankly, our reading of the Star Act proposal is that they are capturing that concept. What they are saying is, let us do something like that in the other program to try to equalize the playing fields in these two loan options for schools.

It is the case that the students at the other end of this that would get the subsidies are not being treated fairly if a school gets a lot more resources to spend, and another kind of school that chooses a different loan program has fewer resources to spend.

So only in the FFELP can you become a school lender, and schools are being asked to look at FFELP, even if they are very

happy with their direct loan participation, because it is a way of tapping into Federal subsidy.

These kinds of adjustments in the two programs are going to require ongoing management. It is not something that you can sit down 1 day and just—it is going to require nuanced legislation over time to try to keep the two programs more similar in their benefits to students.

At the moment, you pay an amount to lenders that includes enough to pay, as you pointed out, the collection costs out of what they get. Also, obviously, you are going to hear today about many wonderful services that are offered. That comes out of the revenue they get by being a lender.

The questions really are that because you have these two very differently financed programs, are they similar enough to treat students fairly? My argument today is that they are not there yet, and they still need adjustment.

But the Direct Loan Program does not have the same level of resources to spend on student and, in some cases, on other coordinated benefits that we are going to talk about today. There will be some testimony about counseling, about resources for the campus. Those are not possible under direct lending.

The University of California has thoughts about how money can be saved if we are looking at Government reform issues. One is, and you mentioned it earlier, to look at the 9½ minimum yield on loans that were made with tax-exempt funding. The President's budget estimated that over a 10 year window, this could save $5.4 billion.

If that kind of savings is significant, and since you are under great pressure to produce savings, we are certainly recommending that you look at that kind of opportunity before you look at taking it away from students, specifically.

It is always the case that some of this money is shared with students. These organizations, as was pointed out, give scholarships and other things. But they are not shared according to the Federal goals. They are not using the principles and themes of access, necessarily. They have choices about how they spend it.

Right now, under the current law, the lenders are allowed to get a guaranteed return on their capital money that they put into the program, and they get the difference in what borrowers pay in interest. So they get what we consider to be a windfall. Capturing that for student benefit is really something that is also needed.

Finally, guaranty agencies are being paid right now on a model that is essentially like an insurance company. We are going to recommend that you look again at guaranty agency competition and make them Federal contractors, and pay them for their services directly. What they do for you, they should be paid for. But the model now is a different kind of model, and it is being used for other purposes that are not Federal principles and purposes.

Thank you for your consideration today.

[The prepared statement of Ms. Coolidge follows:]

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TESTIMONY

"Federal Student Loan Programs: Are They Meeting the Needs of Students and Schools?"

The Committee on Government Reform
U.S. House of Representatives

Presented by

Nancy Coolidge
Coordinator, Student Financial Support
University of California Office of the President

May 26, 2005

Good Morning Mr. Chairman, Mr. Waxman, and other distinguished members of the Committee.

I am Nancy Coolidge, Coordinator of Student Financial Support in the Office of the President at the University of California system-administration office in Oakland, California. I have worked in financial aid at UC for more than twenty-four years and I have been both a student and a parent borrower in various federal loan programs.

I am honored to have this opportunity to share my experience with you, and to relay to you messages from the talented and committed financial aid professionals who serve the more than 200,000 students who attend the University of California.

This is an oversight hearing, and I understand that your committee is not charged with making student loan policy. In my statement, I will outline the University of California's overriding principles with regard to the two largest federal loan programs, Federal Family Educational Loans (FFEL) and Direct Loans (DL); I will address the positive attributes of the FFEL and Direct Loan programs, as well as some features that need to be changed; I will make a number of recommendations about how the management and efficiency of the two programs could be improved, and about how more equitable treatment of borrowers and institutions can be achieved.

As background first let me say that the University of California consists of ten campuses, with five medical schools and a range of graduate and professional programs, including health sciences, law, business administration, education, journalism, social welfare, and public health. While UC serves more than 200,000 students in its bachelor, master, doctoral, and professional degree programs, it is the smallest component of California's public higher education system, behind the 110-campus community college system serving over 3 million students, and the 23-campus California State University System, serving nearly 400,000 students.

Of our ten campuses, six currently participate in the Federal Direct Loan (DL) program and three take part in the Federal Family Education Loan (FFEL) Program. UC's newest campus at Merced will enroll its first class of undergraduates this fall and will participate in the FFEL program.

KEY PRINCIPLES

UC appreciates the attributes of both the FFEL and DL programs and is here to advocate for the preservation and improvement of both. Following are the principles that form the basis of the University of California's overall message to this Committee:

- **The maintenance of meaningful choice in federal student loan programs promotes better loans and services for all borrowers.** The current choice between these two similar but different programs offers the best of both worlds. On one hand, FFEL is a well-regulated, private-capital-funded student loan program that can help drive technological innovation and improved customer service, and ensure that the DL program does not degenerate into a minimal-service-level government bureaucracy. On the other hand, Direct Loans, a federally capitalized program—*as long as it receives sufficient federal money to provide reasonably competitive types and levels of borrower benefits and to invest in administrative improvements*—can stimulate the privately-funded FFEL program to continue to push down its overhead costs and increase its service quality and borrower benefits. The dynamic tension between these two programs is in the interest of all borrowers and schools.

- **Federal resources, to the greatest degree practicable, should be devoted to the core mission of the programs, which is providing access for low- and moderate-income students to postsecondary education.** This means that we have to regularly review the programs' rules and administrative processes to make sure they are as effective and least costly as possible. Especially in the absence of significant, additional grant support, federal loan programs are critically important in assisting low- and moderate-income students to attend college. These are *access* programs, and the federal purpose should be to serve the interests of low- and moderate-income students and to maximize the federal subsidies directed at such students.

- **Borrowers and institutions should be treated equitably in both federal loan programs.** The FFEL and DL programs were created at different times, under different circumstances, so there are variations in how they are administered at the federal and institutional levels. However, they are essentially part of the same federal loan program, so borrowers should have comparable benefits under both, irrespective of federal costs, and the two programs should not directly or indirectly treat institutions of higher education differently.

The current debate about student loan programs, which in part may have led to this committee's decision to examine the costs and administrative issues in these two federal student loan programs, stems from an imbalance in the competition between the programs. At present, the borrowers and institutions in the Direct Loan program are not receiving enough of the federal subsidy to offer realistic level-playing-field competition to the FFEL program. Because of federal subsidies to lenders and guarantors, FFEL borrowers can currently get less costly loans along with state-of-the-art service from the industry players in the FFEL program. Likewise, FFEL schools can receive

administrative assistance from lenders with their loan processes. In addition, both FFEL borrowers and schools can indirectly obtain additional federal subsidies if their school participates as a "School As Lender," a program that redirects a portion of the current lender yield to the schools, mainly in the form of premiums from the sale of loans. This revenue can then be passed on to borrowers in the form of borrower discounts and benefits and also to other students at the institution in the form of increased gift aid. The federal Direct Loan program has no analogous channel through which schools and borrowers can tap into federal subsidies.

Right now, this imbalance favors the FFEL program and threatens to undermine the utility of the Direct Loan program to inspire the sort of reform and innovation that the FFEL program produced in response to the advent of the Direct Loan program.

Reaching an appropriate and effective balance between having adequate funding to pay for administrative expenses, while at the same time offering excellent borrower benefits in each of the programs is an on-going management issue. As technology changes and market conditions vary, the programs must be adapted to keep the competition equitable. Congress and the Secretary of Education must monitor the effectiveness of the two loan programs and should be prepared to "tweak" the business and policy rules as well as the subsidies to adapt to the market conditions as they change.

FINANCIAL AID ADMINISTRATORS PERSPECTIVES

Our DL campus financial aid administrators tell us they like the following features of the Direct Loan Program:

- *The simplicity of the program administration, particularly since the Department of Education has created a dedicated "performance-based" operations unit—the Office of Federal Student Aid (FSA)—which has made the federal systems interface for the Direct Loan program similar to that of the Pell Grant program.* Financial aid administrators like the fact that they do not have to involve outside entities and that the federal loans come to the students directly through the campus financial aid system along with all the other types of financial aid. From a student perspective, having just one loan choice helps to simplify the very complex financial aid application process

- *The responsive customer service that our campuses receive from the Direct Loan program administrators at the U.S. Department of Education.* In general, the campus aid administrators feel that borrowers are well served by the Direct Loan staff, although some of the financial aid administrators are primarily familiar with the treatment of students while they are enrolled in school and not as much thereafter during repayment.

- *The flexibility in being able to create and fund a loan in a short period of time, and to change the amount of a disbursement, if necessary.* Aid administrators like being able to provide top-noteh service to the students at their campuses.

- *The absence of marketing solicitations.* Most DL administrators appreciate not being inundated with FFEL marketing solicitations and feel that the DL program shields borrowers from aggressive marketing by some FFEL lenders. Students are typically ill equipped to evaluate and make informed rational choices among FFEL loan offerings.

Our Direct Loan campus financial aid administrators note the following problems, which primarily relate to inequities in how the FFEL and DL programs are administered:

- *The treatment of the federal savings associated with the DL program.* The federal savings attributed to DL school participation in the DL program are not returned to their students.

- *The pressure they are under to leave Direct Lending in order to participate in "School As Lender."* This FFEL program option is seen as a means to direct some of the federal subsidy available in the FFEL program to students. Aid administrators do not want to be forced to leave the DL program to achieve this result.

- *The fact that borrowers in FFEL can obtain zero-fee loans because certain lenders share their federal subsidies with select borrowers.* Borrowers in the Direct Loan program do not have this option, despite the fact that the Congressional Budget Office (CBO) has estimated that the Direct Loan program is significantly less costly to the federal taxpayers.

- *The fact that the continued availability of "Section 458 funds," which are intended to support administrative expenses in all the financial aid programs, are continually at risk of being cut.* This would harm the Department of Education's ability to make system improvements in the DL program that are needed to stay competitive with the infrastructure reinvestments that FFEL lenders are able to make using indirect federal support.

- *Other inequities in subsidies between the FFEL and DL programs.* These include a guaranteed subsidy to FFEL lenders that allows FFEL lenders to help FFEL schools with their administrative costs, while no equivalent administrative overhead payments are available to DL schools.

- *The lack of access to "good deals" on alternative loans.* Because loan limits have not been increased in over a decade, students have a growing need to borrow alternative loans and most DL schools cannot manage to obtain alternative loans on the same terms, as can the schools that are in a position to direct their FFELP borrowers to the alternative lender.

Our FFEL campus financial aid administrators tell us they like the following features of the FFEL Program:

- *The most competitive prices.* Aid administrators like the more attractive loan terms (*i.e.*, low origination and guarantee fees and "back end" repayment discounts) that are available from their lender, servicer, and guaranty agency partners in the FFEL program.

- *Responsiveness of FFEL lenders.* Their lenders listen to them and provide assistance that is not "one size fits all;" it changes as campus needs change over time. Lenders tailor their services and benefits to campuses and their borrowers to meet the particular needs identified by the campus administrators.

- *FFEL lender assistance.* Lenders relieve the campus of some of the administrative work associated with the creation and maintenance of the loans, and as a result, some campuses have been able to reduce their staff time devoted to work on student loans. Examples of this assistance are user-friendly web-based processing for a variety of labor-intensive steps, such as handling of promissory notes, following up on borrowers, and tracking disbursement changes; as well as staff training, software upgrades, borrower counseling materials, assistance with exit interviews, and, on-line, real-time access to information for schools and borrowers.

- *Access to alternative loans.* FFEL campuses have easy access to reasonably priced alternative loans that their lenders make available to their borrowers.

- *The attention and assistance of the representatives of the student loan industry.* FFEL lenders consult campuses about program and service modifications by including them in school advisory groups, user surveys, focus groups, and other consultation on new products or processes.

Our FFEL campus financial aid administrators note the following points of minor dissatisfaction:

- *"In school" consolidation option.* FFEL continuing borrowers should not be at a disadvantage compared with continuing DL borrowers when it comes to loan consolidation. Right now, if FFEL borrowers want to consolidate their loans while still in school, they must request early conversion to repayment and waive their right to any grace periods at the time of the request or in the future. This is not the case for DL borrowers.

- *Ability of extended repayment options.* Borrowers in repayment in the FFEL program should have the same extended repayment options that are available in the DL program. Currently, DL borrowers who owe more than $60,000 can opt for extended repayment of 30-years, compared to FFEL's limit of 25 years. On the other hand, our aid administrators accept that the Income-Contingent

Repayment Program (ICRP) is rightly only a part of the Direct Loan Program. This makes sense for borrowers when the FFEL income-*sensitive* repayment plan is not sufficient, because the ICRP must link to IRS income data and because it cuts federal costs. However, they would want to modify some of the current restrictions on the FFEL income-sensitive repayment plan.

- *Treatment of Perkins loans in FFEL consolidation.* The federal government should provide "in school" deferments to Perkins loans included in an FFEL consolidation. This means interest would not accrue if borrowers return to school at least half time, and would be more equivalent to how Perkins loans are treated when they are included in DL consolidation loans.

- *Ease of making changes in disbursement amounts.* Some campus FFELP administrators agree that reducing a disbursement amount of an FFELP loan is more labor-intensive than it is in the DL program. Making changes in loan amounts is more of a hassle in FFEL because the reconciliation process occurs as the loans are actually disbursed, rather than after the transaction is completed.

What features of the Direct Loan program contribute to the checks and balances for the overall betterment of the federal student loan enterprise?

In general, the Direct Loan program should be able to operate as a cost-effective, basic government service run on the model of using third-party contractors under the supervision of the U.S. Department of Education. The Direct Loan program must be the lender of last resort, ensuring that federal student loans reach all eligible students attending eligible institutions. In addition, the Direct Loan program should continue to be the repository for the recovery or resolution of Stafford loans for defaulted borrowers. The Secretary should assume responsibility for those who cannot realistically repay what they have borrowed, including but not limited to, borrowers in the Income Contingent Repayment Program. Taxpayers should not have to pay a premium for the maintenance of non-performing loans, and borrowers who cannot pay should not be subject to aggressive collection measures. These special roles are expected of the Direct Loan program in fulfillment of its federal social mission.

By overseeing the operations of the Direct Loan program, the Secretary of Education can make more informed policy decisions concerning the fair treatment of student loan borrowers in both loan programs and can set a standard for servicing conduct that is consistent with the college participation goals of the federal student financial assistance programs.

What features of the FFEL program contribute to the checks and balances for the overall betterment of the federal student loan enterprise?

The FFEL program should be a showcase for innovation and efficiency, setting the bar for the administration of the Direct Loan program and the basis for determining the resources that should be provided for the administration of the Direct Loan program. The

community will look to FFEL for improvements, for example, in communication among parties to each loan, borrower financial literacy education, on-line entrance and exit counseling, and processing of loans using the most appropriate new technologies.

The FFELP community has used its resources to engage the services of some of the best analytical and practical innovators. Their positive contributions have been useful to borrowers and schools in both of the federal loan programs.

It is interesting to note, in surveying the UC campuses, most of the FFEL administrators acknowledge that the creation of the Direct Loan program has resulted in significant improvements in lender responsiveness to community needs, improved borrower benefits, and boosted innovation and levels of service. They all share the hope that the DL program will continue and thrive, because FFEL borrowers and schools are indirect beneficiaries.

Similarly, a nimble private-sector program is necessary to ensure that the Direct Loan program stays effective and does not become bogged down with problems related to inadequate funding, or personnel, procurement, and outsourcing inflexibilities. Further, serving as lender of last resort and offering the Income Contingent Repayment Program are two important features that are best administered by the federal government. In addition, American taxpayers and borrowers in both programs benefit from having DL as a viable alternative to FFEL. Certainly, stimulating private capital markets to participate in this massive social program is not the most economical model; however, it is worth something to have the vitality and variety of service models that the private sector brings to the student loan enterprise.

The questions before us now are: Do we pay too much for that incentive to participate? and if so, how do we reduce the costs without putting out the spark of imagination that keeps both programs similarly useful and responsive to their clientele?

CONSIDERATIONS

Having asked this question and having outlined the pros and cons of each program, the University of California can offer the following thoughts. If implemented, these changes could provide improved equity in borrower benefits, increase federal support for aid to low-income students, and improve program efficiency:

Eliminate the 9.5% minimum lender yield on FFELP loans made or purchased with pre-October 1, 1993 tax-exempt funding.

This special rule was developed to make it practical for non-profit lenders to participate in the federal loan programs at a time when the financial markets were very different than they are today; this special rule no longer serves that purpose. In fact, this provision is now simply diverting a large percentage of the federal special allowance funds to a few select lender participants. While the practice is currently legal and there is no implication of wrongdoing, the purpose and usefulness of this provision is long past and the practice

of continuously rolling over these specially financed loans should be curtailed. In fact, a recent Government Accountability Office (GAO) report found that these guarantees had given lenders at least $1.7 billion more in federal subsidies than they would have otherwise received, and the estimated savings associated with reform of this no-longer-needed provision would save $5.4 billion over the next 10 years. The savings from reforming this excess-profit provision are badly needed to fund other critical student aid programs.

Eliminate the "windfall" interest income to lenders that results when borrowers pay interest amounts that exceed the lender's guaranteed return under the law. At present, borrowers are repaying at interest rates that result in lenders collecting amounts that are greater than their statutory entitlement. The Administration has estimated that the "savings" from limiting the lender to no more than the guaranteed return would be $18 billion dollars over the next ten years.

Pay guaranty agencies for the federal services they provide under the FFEL (and possibly also the DL) programs on a "fee for service" basis.
The need for the hired services of guaranty agencies should be a function of the FFEL or DL programs at the discretion of the Secretary. FFEL borrowers should not be required to finance the operations of guaranty agencies, so the current one percent fee should be eliminated. Perhaps the loss of this fee will result in fewer guaranty agencies staying in the marketplace, but the lenders, borrowers, and schools could still have their needs met by the remaining guaranty agencies, provided an appropriate fee-for-service compensation is set. The goal of this fee-for-service model would be to align the financial incentives more appropriately with the social goals of the federal student aid programs. This model would eliminate certain current compensation incentives, which for example, provide more money if guaranty agencies intervene *after* a borrower defaults rather if they prevent a default.

Require that the federal budget totals for the FFEL and DL programs cover the costs of loan administration and of defaults.
Borrowers should not have funds for these functions deducted from their loans at the point of disbursement – while they are in school. Students need the full amount of the loans they borrow. If the federal government wants to increase the speed of the return of federal funds or increase federal collection revenue during the repayment years, Congress could create early repayment discounts for borrowers with low fixed-rate outstanding loans and consider increasing the limits on unsubsidized loans for credit-worthy graduate and professional school borrowers (who now must resort to using alternative loans). In addition, as mentioned earlier, the 30-year extended repayment limit for borrowers with balances in excess of $60,000 should be available in both FFEL and DL.

Provide equivalent federal subsidies to borrowers in the FFELP and the DL programs
Loans in either program should come with a per-capita subsidy for administrative expenses that should be directed at the entity, which delivers the loan to the borrower and maintains the loan while the borrower is in school, in grace, and in repayment. This administrative overhead should be paid as it is earned, and in the case of FFEL loans,

portions of this payment would go to lenders, servicers, guaranty agencies, and those conducting default avoidance, rehabilitation counseling, and collections. When borrowers are unlikely to repay their loans because of extreme financial circumstances, or when loans become too labor intensive to maintain, they should be assigned to the U.S. Department of Education so no further federal subsidy is paid.

In concluding, I want to thank Chairman Davis, Congressman Waxman, and the other members of the Committee on Government Reform for inviting UC to share its views with you this morning. If you have questions or concerns about our comments and recommendations, I urge you to please contact the University of California Office of Federal Governmental Relations at 202-974-6300.

Attachment
Appendix: Background Q & A

APPENDIX

"Federal Student Loan Program: Are They Meeting the Needs of Students and Schools?"
The Committee on Government Reform
U.S. House of Representatives
Testimony Presented
by
Nancy Coolidge
Coordinator, Student Financial Support
University of California
Office of the President
May 26, 2005

BACKGROUND Q & A:

How does the history of the loan programs inform how we got to where we are today?
The original Federal Insured Student Loan program (FISL) had a number of problems, but one of the most important was that the administrators of the program could not reliably move cash quickly enough to reach borrowers when they needed the funds at school, and they could not quickly reimburse lenders for the claims that they filed on defaulted loans. The delays were intolerable, and the paperwork was a mess. Today, funds are moved electronically, so the program features that were designed to address FISL's inefficiencies are no longer useful. Loan tracking is automated in ways that have vastly improved its accuracy and timeliness.

As the loan programs have evolved, perhaps too, there are some features of the early loan programs that may no longer be relevant, or at a minimum, may warrant review in how they operate and are funded. For example:

Why was the Student Loan Marketing Association (SLMA or "Sallie Mae") created?
The federal government created and seeded a secondary market for student loans in order to create capital for lenders who would tie up their cash to make federally guaranteed student loans, since the life-cycle of these loans was so long. The federal guarantee and subsidies encouraged more capital markets to fund student loans. Sallie Mae was originally that Government Service Entity (GSE), and this secondary market grew through the robust expansion of the capital markets willing and able to invest in federal student loans. Today, Sallie Mae is a private entity, not a GSE.

While other smaller secondary markets also entered the market, this means of providing liquidity for federal student loans has in great part been overtaken by "securitization," which involves selling "shares" of large loan portfolios to investors. This allows for sharing of profits and spreading out risk, while generating additional cash to finance new loans.

Now, with the existence of a viable Direct Loan program, is there still a significant federal interest served by subsidizing secondary markets for federal student loans?

Why were state guaranty agencies invented?
Since the U.S. Department of Education was far away in Washington, D.C., and telephone was the most advanced form of communication at the time, state guaranty agencies were created to put a local face on the federal loan program. Banks (which were then generally constricted by state borders, too) administered the program and the guaranty agencies acted as the federal overseers on behalf of the Department of Education. At the time they were financed, not as contractors on a fee-for-service model, but in the way insurance companies are financed. All their compensation came when the agencies took on the loans, and while the agencies do not get much additional compensation after that, they must follow certain rules in stewarding the loans until they are repaid.

This current funding model for guaranty agencies includes a conflict of interest: on one hand, most guaranty agencies are paid to help prevent delinquent borrowers from progressing to default ("pre-claims assistance") but on the other hand, an important source of revenue is derived in collecting loans after they default. The guaranty agencies that recover defaulted loans are paid contingency fees by defaulted borrowers from whom payment is eventually extracted, similar to the collection costs that are paid to commercial collection agencies.

One of the important roles of state guaranty agencies in the earlier days of the Guaranteed Student Loan (GSL) program, which succeeded the FISL program, and is today the FFEL program, was to ensure that all the eligible borrowers at any eligible school in the state had access to a GSL. This involved creating "lenders of last resort," which made loans to high-risk borrowers. Similarly, the state guaranty agency was responsible for overseeing schools in the state with high student loan default rates and for paying lender claims on time and then collecting the defaulted loans that were assigned by the lenders. This state model then gave more local control and deflected operational responsibility and some of the pressure of program performance away from the U.S. Department of Education in Washington.

This decentralized federal presence was expensive, and when federal savings were needed during times of high budget deficits, borrowers were required to help finance it with payment of a "guaranty fee" (usually 1% of the loan.)

While the guaranty agency model was a huge improvement over the FISL model, with today's technology, the program could benefit from even greater economies of scale. The needs of the federal loan program have changed, and the funding model for most guaranty agencies has outlived its initial usefulness.

Are loans less expensive than grants?
During the early 1990's the University of California's Goldman School of Public Policy at UC Berkeley enrolled a number of mid-level administrators from the Dutch

government's ministry of education. These men had come to learn more about how the United States managed its federal student loan program, since the Dutch government had decided to expand university participation in the Netherlands and wanted to develop a partnership with Dutch banks to provide student loans to make attendance possible for broader economic strata of the population.

The Dutch banks were highly resistant to the government's forays to engage them in this enterprise, and administrators from The Hague wanted to learn what made this type arrangement work so well in the United States.

The Dutch government offered to pay local bankers a "social risk" incentive to make student loans but still the bankers refused. The Dutch found that the U.S. had developed a program where the government absorbed nearly ALL the financial losses associated with its loans, and also paid the lenders and the other entities for their overhead on a per unit basis.

The Dutch administrators had imagined that the U.S. had some clever strategy for enticing the capital markets to invest in student loans, when, in fact, they learned that we paid a premium for their participation. It turns out that the costs of loans, while still less than the cost of providing outright grants, was much greater than the Dutch appreciated when the investigation began. The market value associated with "federally-guaranteed" was more valuable than we understood prior to this investigation. Emissaries from other countries came to learn about the student loan system here as well, and in general they found that replicating the U.S. federal student loan model was prohibitively expensive from their point of view. This was a revelation to U.S. officials as well.

How did loans get so complicated?
By the early days of the 1990s, student loans were very necessary, but also labor-intensive, costly, and frustrating from the point of view of the borrowers and the schools. Institutions felt that we were at the mercy of lenders and industry partners who were charging high prices for comparatively poor service. For example, schools were eager to have the lenders and the guarantors standardize and automate more of their software, business rules, and treatment of borrowers, but lenders and guarantors resisted. The GSL lenders and guarantors had no reason to invest portions of their revenue on these sorts of improvements, as schools and borrowers were their hostages. They realized standardization could lead to borrowers and schools switching brands. Schools that served geographically diverse populations were particularly burdened by the variations in lender and guarantor rules, regulations, and software requirements.

Were direct loans intended to simplify the situation?
The advent of the Direct Loan program was an attempt to reduce the higher education community's exclusive reliance on the student loan industry. While it was difficult to imagine that the Department of Education could create a rival loan delivery system, there was a fair amount of interest in creating competition to improve services to borrowers and schools, and also to provide price competition. In most respects, the development of

a Direct Loan program had a significant impact on the levels of standardization, service, and borrower benefits in BOTH of the federal loan programs.

Some of our campus financial aid and loan disbursement offices opted for Direct Loans as an opportunity to upgrade their outdated technologies and to disengage from the marketplace pressures of competing FFEL lenders. Other of our campuses stayed in the FFEL program and were offered similar upgrades by their lender partners, along with better services and more automated options for their borrowers. It was a win-win situation.

What are some of the collateral benefits derived from creating DLs?
The Direct Loan program eliminated the need for the "lender of last resort," and provided a way—through the Income Contingent Repayment Program (ICRP)—to deal with borrowers who could not financially make the required payments on their student loans. Rather than waste taxpayer resources in futile attempts to extract payment from borrowers without means, the ICRP classified loans that were no longer productive, whether that interval lasted a few years or most of the lifetime of the borrower.

The DL statutory entitlement to federal subsidy is to borrowers, rather than to lenders, as is the case in the FFEL program. Commercial lenders were not needed to make federal education loans to the highest risk borrowers. In fact, it is cheaper for the taxpayers to not have FFEL lenders provide loans of last resort, and it's better for borrowers to be in ICRP in the DL program if they are struggling to repay their loans once they leave school. This treatment of defaulted borrowers through the ICRP is a vast improvement over previous practice, it costs the taxpayers less, and it should be maintained for this purpose no matter what other changes are made to the DL program in the future.

The preservation of the income-contingent repayment plan is integral to meeting the social goals of the federal student loan programs. Since the focus is to encourage college access, the federal government should maintain a failsafe option for borrowers who took out education loans in order to attend college, but who cannot reasonably repay what they have borrowed, either in the short run or over their working lives.

Is there really as big a difference in program cost as the CBO says?
This argument is endlessly debated by defenders of the FFEL program, yet it defies logic to argue that the FFEL program, which appropriately must provide a financial incentive to entice private capital markets to make non-credit-based loans to a broad population of students at a wide array of institutions, is cheaper than the government's own program. The FFEL program necessarily costs more, but, if carefully managed, the additional costs can be worth it in order to ensure better administration of the federally capitalized.Direct Loan program. Without the stimulation of the private sector, the Direct Loan program would suffer from resource neglect at the hands of the federal government and have difficulty acquiring new software, better web technologies, staff training, more efficient policies to serve students and schools, etc.

Defenders of FFEL should focus their arguments on whether or not the subsidy provided is "sufficient" to promote the necessary elements that the most competitive lenders can introduce to this very structured, highly regulated program. This is the time to find out how much subsidy is actually required to keep lenders in the FFEL program and still allow the Direct Loan program to thrive.

- If the subsidies are "sufficient" then the private loan program will attract enough private market players to contribute in valuable ways to the improvement of both the federal programs.
- If the subsidies are too generous, the private market will use the federal subsidies to drain the most desirable borrows away from the DL program, and point out that the DL program, which by design, makes and recovers loans made to the highest risk borrowers, has higher default rates than in FFEL.
- If the subsidies are too small, community the private program will stop being innovative and will eventually disappear. Students will then have to settle for fewer choices of lenders and reduced borrower benefits.
- However, if the subsidies are not generous enough to continue to attract a large range of lenders, but still sufficient to keep the most competitive players in the field, that may be an acceptable compromise in terms of program costs and resources for program improvement.

On the other hand, this cost of the DL program depends in part on how well it is managed. Assuming effective management, the program overhead are assumed to be below the cost of FFEL loans, However, even if DL saves money, the additional costs of FFEL may be worth it to ensure competition that keeps administration of the DL program effective.

The current reimbursement model for the private sector is very beneficial for some of the largest players, as they enjoy economies of scale and larger capital bases, which allow them to innovate and expand. Even though many of these lenders operate as private sector businesses, they share their surpluses with schools and borrowers.

On the other hand, even though DL is a government program, it enjoys many of the efficiencies of the private marketplace as well, because it uses competitively bid private-sector contractors to do administrative work and for collection follow-up. However, since the majority of DL borrowers are not yet in repayment, and since DL is the appropriate repository for high risk and failed borrowers, the costs of the DL program may appear to be higher. In reality, the costs more complicated and comparing DL and FFEL costs is not a simple apples-to-apples match.

The real conversation should be about how much more is a viable private sector option worth to the taxpayers in terms of maintenance of two viable federal student loan programs, each providing an antidote to the strengths and weakness of the other.

Chairman TOM DAVIS. Thank you very much.

Ms. Hart, I am going to need to swear you in.

[Witness sworn.]

Chairman TOM DAVIS. Thank you very much, and thank you for being with us.

STATEMENT OF NATALA HART

Ms. HART. Mr. Chairman, members of the committee, and respected colleagues and guests, my name is Tally Hart. I am the director of student financial aid at the Ohio State University. We serve as the Nation's largest direct lending institution. In the last fully completed year, we offered and administered $246 million in direct loans to nearly 29,000 students.

Prior to 1994, when direct lending was introduced and available, and I had already by that point worked 20 years in public financial aid offices, we at Ohio State were essentially like other institutions of a national scope, taking the same student loan data, sorting it into 60 different formats, shipping it and trying to figure out where the student loan proceeds were in the process.

It took us, on average, 8 weeks into the beginning of the term, after the full summer's hard work on student loans, to actually deliver the proceeds to students.

As the result of direct lending, we were able to have loans follow a single path and to deliver virtually student loans to our students in time to be matriculated in class, have their books, and not begin their challenging academic curriculum worried about, will I have a place to live at the end of this week, and will I have a meal. Their loan proceeds were in hand.

We did begin the Direct Lending Program in what some would conclude was a very shaky mode. We did not have much automation and we literally hung a PC from our mainframe system to deliver this huge amount of money to our students.

But the risk was worth it, and the Department of Education has certainly improved the back end processes since that time. So earlier claims that you might have heard about reconciliation and other administrative functions, I believe, operate very smoothly. We do not believe that we spend a great deal of administrative time or waste in taking care of those functions.

We, above all, have used the time effectively that the students used to spend in our office waiting for their loan funds in very productive ways. There are two major things that we have done with the freed-up time. First and foremost, we have become financial literacy educators. This last year, we delivered more than 3,000 hours of personal financial skills information to our students. This was everything from how to do a budget and balance a checkbook. Every class includes instruction about good and bad uses of credit cards. We teach identity theft, how to avoid it, of course, and savings and investing.

Our students have really benefited from this opportunity. Our staff benefit from the opportunity to be proactive with our students, rather than to wait until they have difficulties or, as we found previously, incurred more loans, because they did not understand how to manage their money correctly.

Direct lending has served us extremely well, and the people who have benefited most, without question, are the neediest students. Assuredly, middle income students borrow and need these funds. But the administrative efficiency gives us time to focus on students with the highest level of need.

One of the issues that you asked me to comment about is the continued efficiency of the program. I would encourage, as your colleagues consider reauthorization of the Higher Education Act, continuation of the Perkins Loan Program and no cost, important options, such as the Quality Assurance Program, an experimental sites program.

These activities, drawn together, enabled Ohio State to do cutting edge research on our student population. The chart that you see before you, and it is displayed on the overheads, shows our success. The bottom blue line shows the rate of matriculation, through the fall of 2000, of our lowest income students. Those are students who have ability to pay for college of about $100 a month. They are, on average, families with less than $30,000 of income.

Through our research, which started to focus on what created student loan defaults, we found important findings about retaining and then attracting, as well, our neediest students. The results from fall 2001 were considered a success, and 2002 and beyond—I love to describe as a financial aid administrator's nirvana—that we have our lowest income students matriculating at the highest rate of all.

Importantly, if you begin to follow the data 4 years after, you would see that our retention and graduation rates are now following a similar plan. So not only are our lowest income students coming to college at good rates, they are remaining and graduating.

This has been a direct benefit of the combined effort of the efficiency of direct lending, the availability of Perkins loans to mitigate against the low student loan limits in the freshman and sophomore year under Stafford Programs, and to have research incentives through quality assurance and experimental sites to figure out these problems and apply the outcomes.

I would point out that our results are regularly shared back to the Department of Education and with colleagues, whenever asked. So we think this creates best practices and knowledge that helps benefit not only Ohio State students, but the Nation's students as a whole.

Thank you again for this opportunity to testify. I want to especially thank you for all of your efforts on behalf of the 35,000 students who, at Ohio State, benefit from your efforts to support and invest in them. They will prove the best investment you can make, thank you.

[The prepared statement of Ms. Hart follows:]

Statement of Mrs. Natala K. (Tally) Hart
Director, Student Financial Aid
The Ohio State University

before the

Committee on Government Reform
U.S. House of Representatives
May 26, 2005

Mr. Chairman, Members of the Committee, respected Guests and Colleagues; my name is Tally (Natala Kleather) Hart. I am the Director of Student Financial Aid at The Ohio State University, and am pleased to be with you today to describe the improvements in student loan systems in the last decade that have served our society well by assisting human capital development through increased educational opportunity. These improvements have benefited first and foremost students of lowest economic means with highest potential to contribute to our nation and the world.

Prior to 1994 when I had already worked for 20 years in public financial aid offices, the same student loan data for Ohio State alone was arranged and rearranged in as many as 60 different data formats. The paper process and accompanying electronic tapes were shipped to the more than 50 student loan guarantee agencies. Response, correction, and funds were returned months later, and were very difficult to track while in process. At Ohio State, the majority of student loan funds became available eight weeks into the first quarter, requiring added steps for students to be enrolled while awaiting funds. Essential costs such as books were borne by the student and family, or done without by borrowing, copying, and central library access.

What was lacking was a single path process that could be followed and which delivered funds to students in a timely manner. By "timely manner", I mean in a way that permitted the student to be in the classroom with the appropriate books and materials, thinking about the subject matter rather than worrying about absent books and stop gap living arrangements. We have documented the importance of these first days of classes and know that the first six weeks of attendance are the most crucial for retention and graduation. Prior to the process improvements of Direct Lending, students did not have finances in place until the eighth week of the term, on average.

Direct Lending at Ohio State was begun with a hope and a prayer for better service to our students. Initially, down stream activities such as reconciliation were not well defined in contrast to the subsequent improvements. Nonetheless, the stakes were so

critical to access that the risk was a prudent one. We were participants in year 2 of the DL Program, and conducted the nation's largest DL operation on a personal computer hung from our mainframe. Even in that shaky environment, we immediately improved the process control and delivery of resources to students. Above all, our students could be in class, focused on the learning process rather than standing in line in the financial aid office uncertain about whether higher education was a possibility.
From those meager beginnings, delivery of the major financial aid program improved. Few students had delays in funds. Financial aid offices had time to assist students least able to navigate entry into higher education. We will never know the lost talent of those who saw long lines at the financial aid office, concluded higher education was not really accessible, and left without capitalizing their enormous potential. A poignant, personal history of this issue is presented by our former Dean of Law and now CUNY City College President, Greg Williams.[1]

Because the inherent competition between DL and FFLEP grew, the single path process became available not only at DL schools, but at all colleges. Colleges had a great incentive to invest in improved computing for the financial aid office to optimize the delivery of aid to students. Increased accountability also followed; the flawed process was no longer an excuse for poor service to students.

There were conversations during that conversion about what aid offices might do with all that freed up time. Would students really understand this was borrowed rather than gift funding if it was delivered readily? My talented staff would be bemused by those statements today.

What we do with the freed up time is educate: we provide strong entrance counseling, we research and obviate the factors that lead to student loan default, and we focus on the neediest families who require reassurance about the aid process. The Greg Williamses today stand before the financial aid counselor and are assured that the system is exactly for persons without means.

To my staff, the most important use of those crucial first weeks' time is teaching. We teach more than 3,000 class hours in Ohio State's Success Series. Modeled on John Gardner's work about what leads to student success, we know that the third week of a student's first term in college is when financial skills make or break the college going process. Rather than standing in a financial aid line, our students are selecting an hour to spend learning about personal financial basics, saving and investing, and – most popular – good and bad uses of consumer credit. Accompanying my testimony are the courses and learning objectives of those courses. They have made a difference as part of comprehensive plan to yield parity between needy and non-needy students in graduation rates. Our student loan defaults in the DL Program are at an historic low: 2.7%. I assure you zero is our goal.

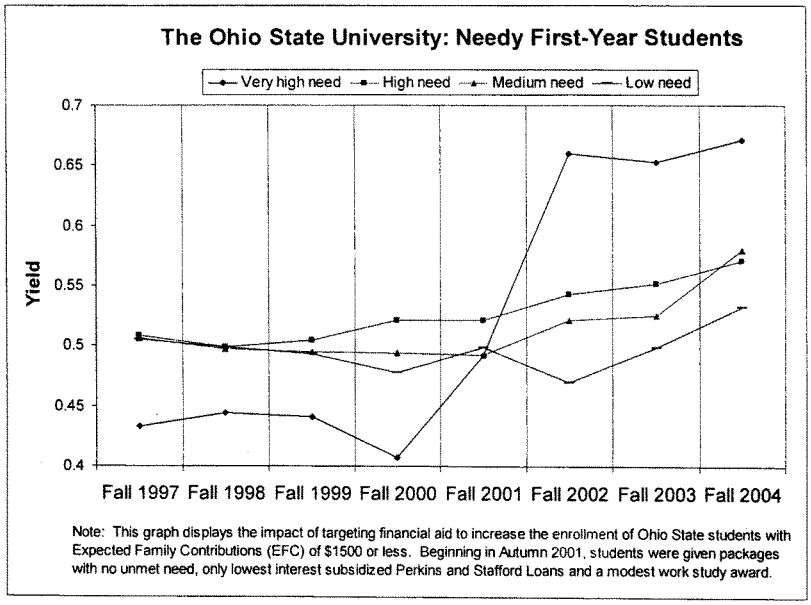
We at Ohio State believe both FFLEP and DL working together have resulted in the most effective and efficient improvements in the financial aid system. While we

[1] Williams, Gregory. *Life on the Color Line The True Story of a White Boy Who Discovered He Was Black* 1995

remain steadfastly a DL school, we encourage continuation of FFLEP as well as DL, as competition makes both programs more receptive to students' needs.

You also asked that I comment about other facets of the student aid process that have improved efficiency and effectiveness. I commend you for your continued support of the Perkins Loan Program, the Quality Assurance Program and the Experimental Sites Program. Attached to my testimony is detail about use of these programs in conjunction with DL to do research and apply it to processes for our students, and the incentives therein to share that knowledge with the federal government and other aid offices in the spirit of best practices.

I will end with my favorite factoid, my version of financial aid nirvana. The graph I display shows the matriculation rates of Ohio State's neediest students before and after these combined efforts were applied. Our retention and completion rates of these students with average family incomes below $30,000, families able to contribute less than $100 a month to our total monthly costs of $1,750, are now equal to those of less needy students and those with family ability to pay full costs.



Thank you again for this opportunity to testify before you. On behalf of our 35,000 aid recipients, thank you for your support and investment in them. They will prove the best investment you ever make.

The Ohio State University First –Year Success Series Personal Finance Classes

Financial and Debt Management

Checking Accounts 101

If you are totally comfortable balancing your checkbook, this is not for you! On the other hand, if you're wondering what we're talking about; join us for an in-depth look at checking accounts and how they work. You may save yourself some money by learning how to handle your checkbook register, balance your statement, and manage your debit card!

Financial Aid 101

Come and learn about the factors that determine eligibility for financial aid, a description of aid programs, and the effects of enrollment changes on maintaining aid eligibility.

Financial Aid 102
Financial planning for education is an on-going process throughout a student's college career. This class will encourage you to consider your educational costs and assess your available resources. We will discuss how financial aid can be used to the maximum benefit and how planning can help minimize your educational loan debt.

Financial Independence

This is a guide for you to understand the importance of developing a spending plan while in school.

Landlords, Leases, and Liabilities

Thinking about moving off-campus? Learn about your legal rights and responsibilities as a tenant. This program will give you the information you need to protect yourself when you sign your first lease, to get your security deposit returned to you at the end of your lease, to ensure that your apartment is safe and in a good state of repair, and to choose compatible co-tenants.

Living Cheap!

How can you stretch your dollars so that you get the maximum enjoyment from every cent? It's just a matter of learning to "Live Cheap!" Join us to talk about ways to make your college experience less expensive and to share some creative ways to live for less!

Savings and Investing

Learn the basics of saving and investing for now and future years. The best investment opportunities will be described as will the basics of financial planning. You'll have an opportunity to evaluate the best investment options.

Understanding and Using Credit

This session will concentrate on doing the math of buying on credit.

What Are You learning from Your Job?

This is a discussion of part-time employment while at Ohio State, including work-study positions and what students can gain from their experiences.

Work Hard but Smart: How to be Successful in School and Graduate on Time

This session will show you that it's important to complete your studies in a minimum amount of time. It will offer tools for you to keep your debt at a manageable level. The importance of time management, study, test-taking and effective communication skills will be covered.

Chairman TOM DAVIS. Thank you very much.

Ms. Thornton, thanks for being with us.

STATEMENT OF CYNTHIA THORNTON

Ms. THORNTON. Thank you and good afternoon, Chairman Tom Davis and members of the House Committee on Government Reform. On behalf of Dillard University, its faculty, staff, and students, I thank you for the opportunity to testify on Dillard University's participation in the Federal Family Education Loan Program and the William D. Ford Federal Direct Loan Program. I am Cynthia Thornton, director of financial aid.

It is my desire that at the conclusion of this testimony, you would clearly understand the contributions of private lenders and continue your support of the Federal Family Education Loan Program.

Dillard University is a private Historically Black University located in New Orleans, LA. Last year, more than 2,000 of our 2,200 students utilized private lenders to fund their education. Our student loan volume is $18 million, or 60 percent of the total $34 million awarded in financial aid.

Dillard University entered the Federal Direct Loan Program in 1995 after the program was 2 years old. We were relatively satisfied with the Direct Loan Program, until we experienced problems that halted the delivery of funds to our students.

At the time, the Department of Education made a transition to a new Government contractor. This transition was difficult on behalf of the Department of Education and our school. Our student loan services were interrupted for an extended period of time, which created a financial crisis for both the school and loan recipients awaiting funds to meet their financial obligations. After evaluating these challenges, Dillard University made a decision to return to private lending in 1997.

We prefer private lending versus Government lending because of the value added services and benefits that the students, the school, and the community receives. These services are offered at no additional cost to the school. The Government contractors are for profit and offer no additional services to the higher education community.

On the other hand, many private lenders return a huge investment to higher education by providing community outreach and scholarships. For example, over the past 2 years, seven Dillard University students have applied for and received scholarships from the Sallie Mae fund. Dillard University's preliminary cohort default rate is 4 percent. By utilizing USA Funds Financial Literacy Program and its default management software, we except even lower default rates.

Through the assistance of private lenders, Dillard University has received complimentary printing of pamphlets, forms, brochures, flyers, and such. In addition, private lenders offer innovative technology solutions to help us deliver aid to students in a seamless manner. This is important to us because budgets are tight and resources are scarce for many Historically Black colleges and universities.

I urge your support also for increased loan limits. The current annual Federal loan limits do not cover our tuition costs of $11,760.

Our students, like students nationwide, supplement Federal loans with private loans offered by private lenders. The Department of Education does not offer a private loan program.

Had we continued in the Direct Loan Program, many students would have had to participate in both Government lending and private lending to meet their educational cost. This is another reason why Dillard University chose to return to the Federal Family Education Loan Program. We needed a streamlined process, and the FFELP Program does that for us.

I will now just take an opportunity to express my opposition for House bill 1425, the Student Aid Reward Act, or the STAR Act, for the following reasons. It promotes inequity among financial aid recipients. It shifts expenditures to the Federal Pell Grant Program. There has been recent controversy surrounding the Federal Pell Grant Program that makes this act tenuous, at best.

The value of the Federal Pell Grant has not increased in at least 3 years. Proponents of the STAR Act believe that it will save the Government billions of dollars. I am no economist, but I do believe that this may be misleading. If one saves a dollar in the Federal Direct Loan Program and spends a dollar in the Federal Pell Grant Program, has the Government really saved?

I have worked in the higher education industry for over 19 years. All of my experiences have been at minority-servicing institutions that suffer from budget cuts and scarce resources. It has been beneficial to Dillard University to partner with private lenders who offer services to bridge the resource gap. For this reason, I urge your support of private lending.

Dillard University and other institutions that chose to participate in the Federal Family Education Loan Program prefer the flexibility and value-added services that this program offers.

Competition between both private and Government student loan programs has resulted in lower student loan costs and specialized loan services that best meet the needs of schools, students, and parents.

I would also disagree with the notion that the Federal Family Education Loan Program is costing taxpayers millions of dollars. I believe that private lenders actually save money for both the Federal and State Government and taxpayers. As the cost of education continues to increase, more and more schools will continue to depend on the assistance of private lenders to help subsidize the cost associated with higher education.

Please continue to give students, families, and schools a choice in student lending that offers equity and access. Please oppose the STAR Act. Thank you on behalf of Dillard University.

[The prepared statement of Ms. Thornton follows:]

Management and Performance of the Federal Family Education Loan Program and the William D. Ford Federal Direct Loan Program

Committee on Government Reform Hearing
May 26, 2005

Testimony of
Cynthia Thornton
Director of Financial Aid
Dillard University, New Orleans, LA

Management and Performance of the Federal Family Education Loan Program (FFELP) and the William D. Ford Federal Direct Loan Program (FDLP)

Good morning, Chairman Tom Davis and members of the House Committee on Government Reform. On behalf of Dillard University, its faculty, staff and students, I thank the members of the House Committee on Government Reform for the opportunity to provide testimony this morning on the management and performance of the Federal Family Education Loan Program (FFELP) and the William D. Ford Federal Direct Loan Program (FDLP).

Introduction

I appreciate the opportunity to discuss the history of Dillard University's participation in both the FDLP and the FFELP programs. I will also comment on which services are most helpful to Dillard University and its students, and the quality of service provided by the Department of Education and other student loan entities. Additionally, I will share my views on why Dillard University transitioned from the FDLP to the FFELP. I would also like to take this opportunity to express my opposition to proposed House Bill 1425, the Student Aid Reward Act of 2005 (STAR Act).

Dillard University is a Historically Black University located in New Orleans, LA. Founded in 1862, it has educated African American students for more than 132 years. For the 2004-2005 school year, more than 2,000 students utilized the FFELP to fund their education. Our student loan volume represents $18 million or 60% of the total $32 million dollars awarded annually in financial aid. As a participant in both programs, we are uniquely qualified to speak about the services of both programs and to discuss which services are most helpful to Dillard

University and our students. It is my desire that at the conclusion of this testimony, you would continue your support of the FFELP and oppose the STAR Act.

Background

The Federally "Guaranteed Student Loan Program" was first authorized in Part B of the Title IV Higher Education Act of 1965 (HEA). The HEA of 1992 (P.L. 102-325) renamed the program the Federal Family Education Loan Program, consisting of Stafford Loans for Students and PLUS Loans for parents. The Student Loan Reform Act of 1993 authorized the Federal Direct Loan Program. The loans offered under these two programs have the same eligibility rules and the same annual and aggregate maximum loan amounts.

The primary difference between the FDLP and FFELP is the source of funds for the borrowers. The federal government provides funds for the FDLP. The FFELP is funded by private lenders, insured by guaranty agencies and reinsured by the federal government ([RPGUSDE], 2003, p. 1 Vol. 8).

Dillard University's participation in the FFELP & FDLP

Prior to 1995, Dillard University participated in the FFELP. Historically Black Colleges and Universities (HBCUs) were strongly encouraged to participate in the Federal Direct Loan Program at the request of the Department of Education. In return, all Direct Loan participants were promised a more streamlined loan application process. Schools were also told they would receive $5 per loan originated as an incentive to help defray administrative costs of the program. At the time, the payments were called Payment of Origination Services (POS). Unfortunately, the payments ended in December of 1996.

In addition to the seamless application process and the POS, the FDLP seemed attractive because students could take advantage of in-school loan consolidations. With interest rates currently as low as 2.77 percent, the ability to consolidate a student loan while enrolled in school could save students hundreds of dollars during repayment. Until this year, this option was only made available to the FFELP participants.

Dillard University entered the FDLP in 1996, after the program was two years old. Initially, it appeared that loans were being delivered in a timelier manner. However, in 1997, the FDLP transitioned its loan origination services from Computer Data Systems to Electronic Data Systems. The transition was difficult on the Department of Education and the schools involved. During this transition, student loans services were interrupted for four to five weeks which created a financial crisis for the school and loan recipients awaiting funds to meet fiscal obligations. For example, the Department of Education's transition problems delayed students from receiving their loans and paying their outstanding balances to the school. For seniors in particular, the process affected meeting graduation requirements and the release of transcripts. After evaluating the challenges the students and the administration were experiencing with the FDLP, Dillard University made the decision to return to the FFELP program.

Dillard's return to the FFELP was a slow process. I believe if one would ask the Financial Aid Office at FDLP schools what is the one element they dislike about the Direct Loan Program, I am sure the overwhelming response would be the reconciliation. In addition to the arduous task of administering the FDLP, reconciling the FDLP was an additional responsibility not required by the FFELP. I recall many difficulties trying to reconcile and close out the program simply because records were lost at the Direct Loan servicer. Even after providing the agencies copies of cancelled checks, it was difficult to bring closure to discrepancies.

We officially closed out our loans with the FDLP at the conclusion of the 2003-2004 school years. Our support to the FDLP has totaled more than $10 million dollars since 1996 as illustrated on the following chart:

	460	$ 1,702,416	$ 35,593
	792	$ 3,245,536	$ 81,561
	255	$ 1,341,613	$ 43,294
	231	$ 1,714,588	$ 15,252
	183	$ 1,309,383	$ 53,930
	68	$ 515,298	$ 17,999
	42	$ 257,501	$ 24,853
	24	$ 168,932	$ -
	16	$ 107,697	$ -
	2,071	$ 10,362,964	$ 272,482
	Total Adj. Oring. Loan Amount:		**$ 10,090,482**
Note: There are only 1,046 unique borrowers at Dillard University			

The Decision to Return to FFELP

Since 1998, more than 500 schools have left the Direct Loan program. Private schools like Dillard University are choosing the FFELP because its lenders offer superior technology and a comprehensive loan program that covers the costs beyond the federal loan limits and services that make the student loan process easier for students and aid administrators. Private lenders have the ability to customize loans and services to meet the needs of students and schools. Dillard University returned to the FFELP out of necessity. We needed a better process that would support the students' needs, our institution's service expectations for students and cash flow goals. More importantly, we wanted to associate with agencies that would compliment and enhance the services already provided.

At private institutions, the average tuition cost is $20,082 (Board, Page 5, Figure 2). The current annual loan limits do not cover Dillard University's annual tuition cost of $11,760 (2005-2006). Private loans offered by private lenders are on the rise nationwide. The Department of Education does not offer a Private Loan Program. Had we continued in the FDLP, many students would have had to participate in both the FDLP and Private Loan Program to meet their educational costs. This is another reason why Dillard University chose to return to the FFELP. Consolidated repayment options are available for our students who have FFELP and additional private loans. The private lenders are working with students and parents to ensure student loan repayments are affordable.

I believe that most HBCUs and other schools will agree that budgets are tight and resources are scarce. Private lenders are able to offer services that the federal government simply cannot offer with the FDLP. Although we made the decision to leave the Direct Loan Program, we continued to participate in both. The Direct Loan Program offered attractive consolidation options that until recently were not available through private lenders.

In 2004-2005, we did not originate any Direct Loans. Instead, we decided to reduce our preferred lender list to four private lenders. These lenders consolidate their services under one umbrella with one of the nation's largest private student lending agency. Each lender provides additional services beyond disbursement of the student loan. These partnerships have enabled us to provide better services to our students and families.

Benefits of the FFELP Program vs. FDLP

The one fact that most institutions agree upon is the benefit of competition. The creation of the Direct Loan Program created healthy competition that has streamlined the student loan application process and lowered default rates. Having participated in both student loan

programs, in my opinion, the benefits of FFELP outweigh those in FDLP. Further, I believe that schools should have a choice in establishing partnerships with external agencies that can help deliver a simplified and efficient student aid program.

Proponents of Direct Loans argue that they offer a single point of service. With the FFELP, schools have a choice of a single point of service when they choose a lending partner. The National Direct Student Loan Coalition (NDSLC) believes that the return of funds is more streamlined by using the FDLP. However, with the FFELP, schools have a choice of a single point of service when they choose a lending partner. Further, the use of the Internet has made return of student loan proceeds easier and more efficient for FFELP schools as well. Dillard University is able to return loan proceeds with ease using the Internet.

The NDSLC reports that the cost for the American taxpayer is $10.51 per $100 for the FFELP program compared to $.69 per $100 for the Direct Loan Program (The National Direct Loan Student Loan Coalition [NDLSLC], n.d.). But, there is more to be considered.

There is an old cliché that states, "You get what you pay for." The one benefit that the federal government has not been able to provide to schools is "value-added services." Value-added services extend beyond the disbursement of the student loan. They include, but are not limited to assistance with entrance and exit loan counseling, staff training and development and technological support. Private lenders are now offering "value-added services" at no cost to institutions. While it may appear that these private companies are receiving huge subsidies from the federal government, the fact of the matter is that a portion of the subsidies is returned to the schools through value-added services. According to the lenders, the profit margin for banks is not as high as in the past, considering the current low interest rates of 2.77% on student loans.

Because lenders return a portion of their subsidies to the higher education community, schools are in a better position to improve services for students. Value-added services are especially important to schools when resources are limited and costs continue to rise. Examples of value-added services offered include, but are not limited to the following:

1. United Student Aid Funds, one of the nation's leading education loan guarantors, offers schools an excellent program titled Life Skills. Life Skills is a cutting-edge program designed to help students better manage their finances and complete their degree program on time. It is an excellent resource for students and schools. Schools are able to help students improve academic performance and budgeting skills, find scholarships and enter repayment with confidence and success. Schools are offered free training and materials to issue to students.

2. United Student Aid Funds also assists schools with default management. Recently, Dillard University was notified that our preliminary Cohort Default rate is 4%. By utilizing USA Funds' Default Management System software, we expect even lower default rates. Not only is the software provided, but training and technical support are provided as well. The default prevention resources and other services are offered at no cost to schools.

3. Private lenders assist schools with entrance and exit student loan counseling, a federal requirement for all student loan borrowers. The federal government does not have the resources to send representatives to schools to share such valuable information with students about the repayment obligations of student loans. Without such assistance from private lenders, schools would be required to perform this task.

4. Private lenders offer both campus-based and web-based training opportunities to schools at no cost. This value-added service is, again, important to schools with limited resources. Oftentimes, we are not able to send staff to conferences and workshops. Having

training opportunities brought directly to the campus saves taxpayers millions of dollars. Imagine how much it would cost the government if a school does not demonstrate that it can effectively administer the federal aid program. USA Funds offers a Speaker's Bureau for schools as an additional resource. Training is not only offered for the financial aid staff, but other campus constituencies.

5. Student persistence and retention have gained national attention in recent years. In fact, Congress is now considering rewarding schools that have high graduation rates and retention rates. Dillard University, in partnership with USA Funds, is able to manage and improve its retention rates using Noel Levitz's Retention Management System. In addition, an annual symposium provides an opportunity for minority-serving institutions to share ideas and concerns about retention. This service is not offered through government lending.

6. Private lenders offer schools assistance with technology. At Dillard University, we were able to improve our web-based delivery system by taking advantage of Sallie Mae's Campus Gateway system. Campus Gateway gives us the ability to deliver financial aid services more efficiently. Our students are now able to go to the web and complete every aspect of their financial aid and tuition payment requirements in one convenient location.

7. Private lenders offer tuition payment plans. This service is not available through government lending. Dillard University elected to partner with a private lender who offered a holistic approach to servicing our students. After financial aid is awarded, this interest free service provides a means for students to meet costs by making payments on their tuition balances. Our students can also pay their tuition via the web because of an additional value-added service.

8. Private lenders support state associations through corporate sponsorship. In the state of Louisiana, private contributions through corporate sponsorship enable our state association to offer a comprehensive conference to meet the needs of the membership. Corporate sponsorship allows participation by more schools lowers membership fees and lowers conference costs paid by schools. Currently, we are able to participate at a membership fee as low as $30. At conferences, private lenders supply schools with much needed office supplies such as pens, notepads, pencils, etc. These giveaways (tokens) might seem small. However, the cost reductions are a great benefit for schools with limited resources.

9. Private lenders offer schools assistance with printing pamphlets, brochures, flyers and forms. With each Reauthorization of Higher Education, the list of consumer information requirements demanded by the federal government gets more expansive. Through the assistance of private lenders, printing costs to schools are minimized.

Opposition to The STAR Act

A group of senators has proposed legislation (H.R. 1425) known as the STAR Act. "The primary purpose of the bill is to ensure that the federal student loans are delivered as efficiently as possible so that there is more grant aid for students (109th Congress, 1st Session H.R. 1425)." According to one report, this program would provide additional funds to students at no cost to taxpayers (Patterson 2005). One of the provisions of the STAR Act is to provide an additional $1,000 for students who attend institutions that participate in the Federal Direct Loan Program (Patterson). We believe this is unfair to the millions of low-income students who have elected to attend schools that use private lenders.

Which student loan program produces the greatest benefit for the greatest number of people? On the one hand, The FDLP eliminates the cost subsidies paid to private lenders, but

shifts a $1,000 per student cost to the Federal Pell Grant Program under the provisions of the STAR Act. Nearly six million students receive more than $12 billion in Federal Pell Grant Funds each year with awards ranging from $400 to $4,050. The potential impact of this legislation represents a shift from one program to the other. On the other hand, subsidies received by private lenders are returned to the institutions in the form of value-added service. When the schools receive value-added services, these services benefit schools, students and families and communities. The government-contracted servicers of student loans are for-profit and offer nothing in return to the student, the school or the community. On the other hand, many private lenders return a huge investment to higher education by providing community outreach and scholarships. For instance, the Sallie Mae Fund, a charitable organization sponsored by Sallie Mae, achieves its mission of increasing access to higher education for America's students by supporting programs and initiatives that help open doors to higher education and increasing access to higher education. This organization has donated more than $12 million to educational programs, scholarships and community service. Additionally, private lenders offer scholarships for students.

The National Association of Student Aid Administrators (NASFAA) represents more than 3,000 schools. Preliminary investigation of the STAR Act by NASFAA's Task Force on Reauthorization indicates that the organization is not in support of this bill. It is the Task Force's opinion that the STAR Act does not comply with its first principle for decision making, which is to "**promote fairness and equity for students across all sectors of post secondary education** (NASFAA 2005)." Students should be able to receive the same benefits regardless of the school they choose to attend. The standards of equity and access would have to be questioned when students are rewarded for participating in the FDLP vs. the FFELP program.

The Committee on Government Reform should oppose the STAR Act and consider the opinion of the financial aid community that is charged with annually administering billions of dollars. It is difficult for financial aid administrators to explain inequities in financial aid awards from school to school driven by the decision to participate or not participate in a particular aid program. Because of the STAR Act, I believe we would be inundated with calls and complaints from parents and students. Imagine the parent of two children who attend different schools, one a direct loan participant and one a private loan participant. It would be difficult to justify to a parent that his or her son or daughter received an extra $1,000 in Federal Pell Grant funds because the school chose to participate in one loan program versus the other.

The STAR Act would impose additional expenditures to the Federal Pell Grant Program. The major incentive for participating in the FDLP is the $1,000 increase to the Federal Pell Grant. However, recent controversies surrounding the Federal Pell Grant formula and funding make this tenuous at best. In December of 2004, changes were made to the state formula for calculating Federal Pell Grant awards designed to save $300 million. Reports indicated that 84,000 students were expected to loose their grants completely and millions more would see a reduction in their Federal Pell Grant Award. It is my opinion that public outcry contributed to President Bush's proposed legislation that would increase the Federal Pell Grant by $100 per year over five years. The proposed change would substantially increase Federal Pell Grant spending by $400 million dollars (Committee for a Democratic Majority 2005).

The value of the Federal Pell Grant has not increased in at least three years. Yet, the total Federal Pell Grant funding has grown from $9.17 billion in fiscal year 2001 to $12.37 billion in fiscal year 2005 due to the increase in applicants. If a $100 increase to the award would cost the government $400 million, how would the proposed $1,000 increase impact the federal budget?

Based on recent Federal Pell Grant Program budget debates, Committee Members, I urge you to oppose the STAR Act. The goal of President Bush's FY 2005 Budget was to reduce spending. Proponents of the STAR Act believe that it will save the government billions of dollars. I am no economist, but I do believe that this may be misleading. If one saves a dollar in the Federal Direct Loan Program and spends a dollar in the Federal Pell Grant Program, has the Government really saved? Furthermore, students always appreciate more grants than loans. Unfortunately, the STAR Act does not promise a $1,000 grant to all eligible students. Equity is lost.

Conclusion

I have worked in the higher education industry for 19 years. All of my experience has been at minority serving institutions. Each of the institutions has suffered from budget cuts and scarce resources. For this reason, I urge your support for private lending and ask that you oppose the STAR Act. Dillard University and other institutions that choose to participate in the FFELP prefer flexibility and the value-added services this program offers.

Today, private lenders offer loan programs that are seamless for students, parents, lenders, guarantors and the financial aid staff. Reconciliation in the FFELP program is much easier than reconciliation in the FDLP. National student loan default rates are lower than ever before because competition between the programs prompted programmatic changes and lenders are offering more assistance to schools to reduce loan defaults. Families are able to take advantage of affordable tuition payment plans offered by private lenders. Additionally, private lenders are offering services to assist schools with improving retention and graduation rates. The return of a portion of their subsidies in the form of scholarships and other value-added services improves the access and equality to higher education for many families.

I am a taxpayer, a higher education administrator, and a parent of future college students. Based on my experience, I would disagree with the notion that the FFELP is costing taxpayers millions of dollars. I believe that private lenders actually save money for taxpayers, federal and state governments.

Each year, approximately 10 million students and their families rely on federal aid to pay for college. As the cost of education continues to rise, more and more schools will continue to rely on the assistance of private lenders to help subsidize the costs associated with higher education. Contributions from private lenders through educational programs, scholarships, and community outreach will be even more important. Taxpayers pay more than $22 billion per year for higher education costs. Because the socioeconomic mix in higher education has barely changed in 40 years, most taxpayers support access to college in the interest of social justice and to improve the national level of economic performance. Congress is aware of the vital importance most citizens place on student aid funding. Please continue to give students, families and schools a choice in student lending that offers equality and access by opposing the STAR Act.

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Chairman TOM DAVIS. Well, I want to first thank all of you. I think there is always a divide here on the parties in how we look at this. Our side is traditionally like the private lending. The other side is traditionally like the Government lending.

The one thing I hear from this is that private lending has improved a lot because the Government got into this business. Now it looks like in many cases, there is a momentum back to private lending, because of the improvements made in the competition offer. Is that a fair comment?

Mr. MERTEN. Yes, I think it is very fair.

Chairman TOM DAVIS. Ms. Bauder, do you think that is a fair comment?

Ms. BAUDER. Yes.

Chairman TOM DAVIS. Do you think that is a fair comment, Ms. Coolidge?

Ms. COOLIDGE. Well, I think it is fair to say that the private sector has more money to spend. They are spending it in ways that maybe people appreciate, and that is good.

Chairman TOM DAVIS. They would not have done that probably, if you did not have direct lending. That is my point.

Ms. COOLIDGE. That is correct.

Chairman TOM DAVIS. You can always argue about the Government, that we ought to give Government more money to do the same kind of things or back and forth.

Ms. COOLIDGE. One could say that, or one could instead refocus these resources on the neediest students. That is sort of the heart of the argument, whether the level of support for the two programs is reasonable, given these vast needs of poor students.

Chairman TOM DAVIS. I will tell you what, I represent the wealthiest district in the country, and it is hard to find many families that do not need the aid.

Ms. COOLIDGE. Yes, that is right.

Chairman TOM DAVIS. College education is expensive.

Ms. COOLIDGE. That is right.

Chairman TOM DAVIS. I wrote out, the year before last, $72,000 in tuition checks. So even at our salary, that is a hefty amount. So when it comes to the higher education today, everybody needs it.

For low income, in particular, as you know, I authored the D.C. College Access Act that allows District students to go anywhere in the country and pay in-State tuition.

But when it comes to aid for college, everybody needs it. There are very few families that this does not impose some kind of hardship.

Ms. COOLIDGE. You might want to try a Plus Loan. If you are writing checks for $17,000, you can get a Plus Loan financed at 4.17 this year. I have four children and I am doing that. [Laughter.]

Chairman TOM DAVIS. Well, unfortunately, I got the cash, so I would just as soon get it out and not owe it. I hear you, but thank you very much. Maybe I could get one of my kids to go to George Mason or an in-State school.

Mr. MERTEN. We will give you a special deal.

Chairman TOM DAVIS. OK. [Laughter.]

Listen, every student who goes to George Mason gets a special deal. Is that not right, Dr. Merten?

Mr. MERTEN. Yes, they do.

[Laughter.]

Chairman TOM DAVIS. That is just for the record here.

Do I understand that one of the benefits added is that sometimes under one of the advantages that the private loans have is that colleges can participate and actually make money on it? Is that correct?

Ms. COOLIDGE. Yes, we did a feasibility study at the University of California, where we have six campuses and direct loans, and four in FFELP. We could make about $4 million a year, and most of that would be used to provide very competitive loan benefits to the borrowers themselves.

But there would be approximately $1 million to $2 million, depending on how it was spent, of resources that move would generate for other financial aid at the campuses from Federal subsidies that we would get, just by partnering with a Federal lender.

While we have six campuses that definitely do not want to do it—they are very pleased with the Direct Loan Program and they do not want to leave it—we are under pressure to say, why are you not doing that? If that money is out there and available to schools, why are you passing it up?

Then when we see the STAR Act being proposed, it looks like that is what they are thinking about. Let us bleed some of this resource away for students. That is what I think they are after.

Ms. HART. Mr. Chairman, if I could also respond.

Chairman TOM DAVIS. Yes, Ms. Hart.

Mr. HART. I served as head of a guaranty agency in my former State of residence. That provision, of school as lender, I believe, is really antiquated.

It was placed in the law at a time that there were significant issues of capital formation for student loans. It was critical at that point that institutions that were having trouble with capital formation, especially for graduate and professional students, might want to use the FFELP Loan Program to provide educational dollars to their students.

That simply is not the status today. That kind of unfair playing field, we also at Ohio State have had enormous pressure to move to that option. We have elected not to, for a very sound set of reasons. But I simply believe that provision is no longer needed and should be eliminated from the law, in my opinion.

Chairman TOM DAVIS. Well, I guess, you know, the unfair playing field depends on where you sit on this thing. I think if you are a college administrator, you are just looking for the best deal for your kids. I am not really trying to take sides in this debate, one way or the other. We are just trying to get information here on how efficiently it has been run. That is our focus.

We are going to get an audit back in September that will, I think, be more inclusive in terms of what the real costs are. We have not had a handle on this. Because all we have worked out are some estimated costs that go back a decade, and nobody has come back to look at. We will have, I think, a better handle there, yes?

Mr. MERTEN. Every time you look at this issue, there are three players. There are the institutions, and what is in our best interest, and how we need to operate, and how do we act and operate in a business-like fashion. Second, it is the students and their parents. What are the best services that can be provided to them? Then third, what is the cost to the Federal Government?

I think when we move forward in this, we have to look at all three of those. Sometimes you make decisions, and I think we make decisions, that we have picked an option that might not have been in our own best interests, but it was in the best interests of the students and their parents. So we are always making those kinds of tradeoffs, in all the issues in higher education, but specifically in this one.

Chairman TOM DAVIS. I understand, and I think we will have a better perspective on the costs when we get the GAO back.

Mr. Clay.

Mr. CLAY. Thank you, Mr. Chairman, and I also thank you for holding this hearing. I started at the University of Maryland as a freshman. When I started, the per-credit hour was $15 per hour. So I could go throughout my 4 years of college and pay it out of my pocket. But the costs have really risen.

I have a 4-year old and an 11 year old. So my wife and I realize we will probably have to give our arms and legs to get them through college.

But let me ask, and this is for Ms. Coolidge. I will start with you. We have heard a little bit about how private lenders market their loan products to schools. My understanding is that private lenders use a variety of inducements, such as taking schools administrators out to dinner and on trips and offering school computer systems and software packages.

U.S. News reported on the lavish benefits that some private lenders offer to school administrators when they are marketing their loan program. I am concerned about the potential abuse in these situations. How can we ensure that marketing approaches by private lenders do not involve kick-backs? I will start with you and would like for anyone else on the panel to comment, if they care to.

Chairman TOM DAVIS. May I just intervene? I would just ask this question. There is nothing wrong with taking somebody out to dinner. Are you talking about direct payments?

Mr. CLAY. Those were the examples.

Chairman TOM DAVIS. Yes, that would be fine.

Mr. CLAY. I am not saying there is anything wrong with going out to dinner.

Chairman TOM DAVIS. You are worried about the next step.

Mr. CLAY. Right.

Chairman TOM DAVIS. OK.

Ms. COOLIDGE. I think if you are asking how can we remedy this kind of thing, that is what I was talking before, about trying to make a more level playing field between the two programs.

If the profits are associated, even after all costs which are obviously reinvested and are considerable with people here talking about the wonderful services they get—even after consideration of those great things, the profits that are made in the FFEL Program

are extreme enough so that the school lenders can make as much as we calculated. By trimming that, you can reduce that kind of temptation. Because there will be enough in there to do the proper things for the loan programs and not enough for really lavish sorts of things that you are alluding to.

A great number of dollars are spent on things that schools highly value and appreciate, that do not have that personal quality of sort of kick-back or payoff or that type of thing. So I think those are sort of collateral benefits that come from paying extra for this program. But the question is whether it is too much, and whether we need to modify the reimbursement model, so that it is closer to the other model.

Mr. CLAY. Thank you for that response.

Mr. MERTEN. In our case, the purpose of getting something from the lender is to provide something to the student. That is what we are there for. I mean, that is the place where we play the intermediary role. The student needs something. The student's tuition has gone up, and in many cases has gone up because of the lack of State support. So we have to do whatever we can to help that student. If it is to get something extra from the lender, that is where we go.

Mr. CLAY. Thank you for that answer.

Ms. THORNTON. I would also agree that if a lender offers a service that would help us streamline our process for students then, in the end again, the student benefits from the service and it is not necessarily an inducement for the school. It is a service that benefits the student.

At the end of the day, we are all trying to do our jobs more efficiently and more effective, and deliver the aid to the student. So sometimes, we need a little help, and private lenders offer that service to help us deliver the aid to the student in a timely manner.

Mr. CLAY. I appreciate that clarification. Let me ask Ms. Bauder this. We have heard about how the competition between the two loan programs has had important benefits for students and colleges. But we have also heard about how taxpayer dollars are being wasted because of high subsidies and inefficiencies in the Guarantee Loan Program.

All of you have significant knowledge of student financial needs. Can you provide us with some insight into how we can maintain competition between the two loan programs, while also ensuring that taxpayers get a good deal? After Ms. Bauder, anyone on the panel can comment.

Ms. BAUDER. I think the point here is that we need to do what is in the best interests of the students. Who knows better really than the institution?

I mean, I will look at the University of Maryland. Because we have partnerships with our private lenders, we are able to reallocate funding into different educational programs. We know that financial aid is not a one-size-fits-all program. So we developed Maryland Pathways. So students who have a zero expected family contribution, who are an in-State resident, can come to our institution and not borrow a dime in 4 years.

So I think it is really becoming where we are starting to profile our students, rather than saying, OK, everybody has to take on a loan. The word "loan" may conjure up images of a creditor knocking on a door for one student, where it may be considered a gift for others.

I think the competition between the two programs is necessary. I think direct lending has done a great benefit for the FFELP Program and vice versa.

Mr. MERTEN. If you look at the three different legs, as I mentioned before, one of the question now in front of you and in front of all us as taxpayers is, what really is the difference? The idea of having the GAO study and to make sure that it is a full costed study—too many times in studies that we see done by the Federal Government, it is a marginal cost study. It is not a full cost of the program.

So you need the full cost on both sides. Then it is something that obviously not only should you be interested, but we in higher education and as individual taxpayers should be interested in the full cost.

Mr. CLAY. Thank you for that response.

Ms. THORNTON. I also think it is important, too, to remember that some of the subsidies used by the lenders is returned to the community in the form of scholarships, they are still helping the students. They are helping the communities. I think it is important that you guys really consider that option, as well.

Mr. CLAY. Thank you for that.

Ms. COOLIDGE. There is a bit of cost difference in the sense of full cost consideration. The Federal program, the Direct Loan Program, should have in it the borrowers who are the highest risk and who are the most likely to fail. That is the social mission of the program.

That is going to be an additional cost. If they are in the Income Contention Repayment Program and making less than their interest in forms of payment, that is one of the purposes of these programs, to make it possible for access to occur. Then if at the backend, they are not able to repay, we have a program that suits them and it is not just considered a default. It is really a way of dealing with the students who took the chance we invited them to take and did not succeed.

So in taking into account the costs of the programs, it is really important to calculate the value associated with placing really high risk students into a repayment model that does not cause them to be dropouts from society, that they have a way of being acceptable, not defaulters. I think that is an extra cost.

So when you do this comparison, it really needs to be calculated that we need to have a place, a repository, for the students who cannot pay. I am not talking about the will-not-pays. I am talking about the can-not-pays.

Ms. HART. Mr. Clay, I hope that my summary will be helpful. But I think that it is consistent with all the other comments. In trying to avoid some of abuses that you describe, which I have heard of as well, that if we focus, and we would be glad to assist you if that would be useful, on the benefits to the students, and I include Ms. Thornton's definition about efficiencies. But if that

were the distinction, I think there would be far less concern about the appropriate use of whether they are profits or dedicated services through direct lending. That is the distinction, I think, that we could all agree would be useful.

Those of us who have labored long in these professional vineyards would love to avoid any onus to our profession of things that we certainly would never accept, and yet find great benefits to our students.

For example, Ms. Thornton mentioned the U.S. A Funds Default Prevention Programs and Financial Literacy programs. We use those too, even though we are a direct lender. I would really regret seeing important student benefits, important educational benefits of that eliminated. But saying that those are the types of benefits that could accrue from the program, I think, is very reasonable and it would avoid the concerns which you have, which I certainly share.

Mr. CLAY. I would be very interested in you all sharing that information with us. I thank you, Mr. Chairman.

Chairman TOM DAVIS. All right, Ms. Coolidge, let me just go back you, the "will not pays" versus the "cannot pays," when you give a student a loan when they are going to school, is there not an assumption in every case that they are going to be able to get an education, improve their income, and pay it back?

Ms. COOLIDGE. That is the assumption, and it is certainly the case that most do. But there are students who have health problems, who have mental health problems, who have tragedies in their families who, for various reasons are not able to. It is usually people who do not finish. People who have taken out loans.

Chairman TOM DAVIS. But you do not know that. Do you know that when you are making the loan?

Ms. COOLIDGE. No, we cannot know.

Chairman TOM DAVIS. So those would be handled equally by the private sector and the public sector, would they not?

Ms. COOLIDGE. Except that in the case of the income contingent repayment plan, it is a non-producing asset. It is something where the Federal Government winds up taking a loss, basically, on the amount the student cannot repay.

The question is, do you want that loan maintained in a environment where you are paying basically a premium on the asset, for someone to take care of and maintain it in the private program, or do you want it moved to the least costly repository.

That is why I was speaking of moving those borrowers—whatever program they borrowed from originally—moving them into a Federal environment, where the Feds can, first of all, check their income-contingent repayment against their taxes each year, to find out if they are legitimately getting this treatment, if they are earning more. They can check with the Social Security Administration to see if they are getting more.

So having that kind of borrower's repayment in the Government program makes a great deal of sense. It is not a huge number. It is just that I wanted to say that the cost of this is a legitimate cost, and should be considered when comparing the two programs.

Mr. MERTEN. I learned something in the preparation for the testimony, and that is that our default rate was low. So I asked the

financial aid staff why. The big issue that I got back was: counseling, counseling, counseling.

That is for the borrower to understand what he or she is getting into, and to make sure they are borrowing as little as they need as opposed to as much as they can get. If you have that kind of a philosophy, then I think we have the opportunity to make sure people are borrowing close to where they should be and there will be problems later on. But those problems are based on a rational loan, as opposed to an irrational loan.

Chairman TOM DAVIS. Again, a lot of the incentives that the private sector offers today would not have been there, but for the Direct Loan Program and so on. As we look at this, we want to continue to keep that competition.

But my instinct is that Government is never able to keep up and be competitive with the private markets and their ability to be flexible, because they are just different motivations. Private markets, they operate on a very competitive bottom-line basis. The Government does not. I mean, how many years does it take us to get an audit to just see what the real costs are.

Ms. COOLIDGE. But in fact, this is not clearly the private market versus the Government market. That model is too extreme. In fact, the Government market, as Ms. Shaw testified, uses competitive bidding to outsource quite a few of their tasks. Therefore, they are using the private market as part of their model.

Chairman TOM DAVIS. They do for collections, yes.

Ms. COOLIDGE. It is not just for collections. They do it for all kinds of processing. They use the private industries.

Chairman TOM DAVIS. But they do not have the same competitive arena that they are out there competing in. The competition level is different in the private sector than it is in the Government sector.

Ms. COOLIDGE. Well, let me just speak to that. The private sector is actually heavily subsidized. This a heavily regulated and heavily subsidized Federal program. So the thought that is the free market and this is the Government is actually much more muted than that. There is not as big a difference.

Chairman TOM DAVIS. But in private sector companies, the culture is different than the Government sector.

Ms. COOLIDGE. Certainly, it is culturally different, and that is to our benefit. They also, however, to our detriment in some cases, have stockholders and highly paid executives. So there is both aspects of the good parts and the bad parts that go with that. But the fact is, they are making their money on a Government subsidy, much as some of the agriculture points are. It is not a clear distinction between liaise a fare and Government restriction.

Chairman TOM DAVIS. Well, I think Dr. Merten put it well, when he said there are three legs to this that you need to examine. There are the schools' perspective, the students' and the parents' perspective, and that is where I sit. You know, what is the best deal? Then finally, there is the taxpayers' perspective, and we also have to look at all three of these.

I think this discussion has been very, very helpful to this committee, as we take a look at what is going on. I hope it has been

to Ms. Shaw, for the Department of Education. She has stayed here for the whole thing.

We have a Direct Lending Program, and we want to make it work. Because we understand that competition has made the private sector better. On the other hand, the private sector is getting more flexible and getting more ingenuity every day as they get better. I appreciate everybody's comments as we move forward on this.

So thank you all very much. Is there anything else that anybody wants to say before we leave, that maybe you did not get in?

[No response.]

Chairman TOM DAVIS. Well, thank you very much. This was well worth it. The hearing is adjourned.

[Whereupon, at 12:49 p.m., the committee was adjourned.]

[NOTE.—The Department of Education: Federal Student Aid Packet and additional information is on file with the committee.]

[The prepared statements of Hon. Dan Burton and Hon. Jon C. Porter and additional information submitted for the hearing record follow:]

Opening Statement
The Honorable Dan Burton
Committee on Government Reform
Title: "Federal Student Loan Programs: Are They Meeting
The Needs of Students and Schools"
Date: May 26, 2005
Time: 10:00 A.M.
Room: 2154 Rayburn House Office Building

Mr. Chairman, thank you for holding this important and timely hearing today to examine the management and performance of the Federal Family Education Loan Program (FFELP) and the William D. Ford Federal Direct Loan Program (FDLP). While there has been much debate on the cost of the two federal student loan programs, there has been – until now – little oversight on how the programs are serving their primary beneficiaries, specifically schools, students, and parents.

I know Mr. Chairman that you are working closely with our colleagues on the Education and Workforce Committee to address oversight issues, and I look forward to hearing their point of view on how best to address this question during the Reauthorization of the Higher Education Act. Furthermore, I look forward to examining any plans by the Department of Education to enhance management and delivery of services to students, their families, and their schools, as well as hearing from the universities who actively participate in the loan programs.

As you already know, the FFELP was created in 1965 and allows private lenders to provide government-backed loans to students to help pay the cost of college. The more recent FDLP was created in 1993 and provides student loans directly from the United States Department of Education. Together, these federal student loan programs provide more direct aid to support students' postsecondary educational pursuits than any other single source. As a result, students and their parents enjoy a wider variety of choices to finance higher education than ever before.

I believe this competition has led to greater benefits and more opportunities, including improved customer service, lower fees, borrower financial training, as well as enhanced delivery technology. Even more important, this competition has led to cheaper loans for all students, which ultimately allows them to concentrate on studying and not on worrying about the cost of their education.

Yet, we have a responsibility to identify the current areas of waste, fraud, and abuse in the current system in order to promote even better service to our schools and students. This should not be a partisan issue; it should be an issue about how best to serve our children and assist them in the pursuit of a world-class education.

Today's hearing was not designed to specifically focus on the cost of the Direct Loan program, but in the interest of good governance I'd like to draw the Committee's attention to a few facts about the program. It is interesting to note that 83 percent of schools have chosen to use the FFELP exclusively, including several of our witnesses' institutions: the University of Maryland; Dillard University; and three of the nine University of California schools. In fact, currently, FFELP loan volume represents 75% of the total guaranteed student loan market. Even more interesting – as I have been informed – is the fact that over 500 schools have left the FDLP in favor of the FFELP since FDLP's inception.

Many schools have stated that FFELP offers better benefits and products for their students, better services for the schools themselves, and better technology for both the students and schools. The bottom line is that the program is not achieving the savings it was supposed to achieve. An independent study by PricewaterhouseCoopers reinforces this conclusion, and indicates that the federally-controlled Direct Loan program actually costs taxpayers significantly more than federal budget estimates appear to show. This is simply unacceptable and something we must address during the reauthorization process.

Whether the program can be fixed or whether it should be eliminated is still to be determined, but I want to say that I strongly agree with the Chairman of Education and the Workforce Committee, my good friend and colleague Representative John Boehner, that we should not ask American taxpayers to pay additional money to expand the Direct Loan program, so long as the program fails to live up to it's potential. I firmly believe, as Chairman Boehner and the President do, that taxpayers' dollars should be spent wisely, or not at all. And throwing good money after bad is not spending taxpayer's dollars wisely.

In closing Mr. Chairman, I want to once again thank you for holding this important and timely hearing. I look forward to hearing from the witnesses and hope – by the day's end – that we will have a better understanding of how best to move forward with the Federal Family Education Loan Program and the William D. Ford Federal Direct Loan Program.

Committee on Government Reform
"Federal Student Loan Programs: Are They Meeting the Needs of Students and Schools?"
Statement by Congressman Jon Porter
May 26, 2005

Good Morning, Mr. Chairman. Thank you for holding this hearing today exploring the effectiveness of two of our most important educational programs. As a member of both this body, and the Committee on Education and the Workforce, I look forward to gaining greater understanding of how our federal student loan programs serve the students and schools of this nation. I also thank the witnesses for joining us today as we all seek to provide increased access to higher education, particularly for our lower and middle income families.

As a Congress, we need to look closely at the strengths and weaknesses of both programs, and determine how we can facilitate improvements in both programs. Certainly, for some individuals and schools, the Ford Direct Loan Program offers distinct advantages. The same holds true for the Federal Family Education Loan Program. Through these two programs, our federal government is able to provide approximately $62 billion in financial assistance for post-secondary education. This is truly an impressive amount, and all parties involved should be applauded.

Certainly, with the competition between the Direct Loan Program and the traditional lending program of the FFELP, the quality of services has improved in both programs. We must work to provide a level playing field to continue this competition and thus provide further benefits for students and taxpayers.

As our economy continues to become what is called a "knowledge-based" economy, the need for post-secondary education becomes increasingly acute. As we continue to look at the way in which these two important programs function, we must keep in mind our final goal—the education of the American workforce. I hope to gain greater insight today as to the ability of both programs to provide schools and students with the resources they require to meet the needs of our dynamic economy and workforce.

Again, thank you, Mr. Chairman, for calling this important hearing today. I thank our witnesses and look forward to working with my colleagues on this committee and the Committee on Education and the Workforce, as we seek to improve access to and affordability of higher education in our nation.

UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF INSPECTOR GENERAL

ALERT MEMORANDUM

AUG 1 2003

TO: Sally Stroup
Assistant Secretary
Office of Postsecondary Education

FROM: Cathy H. Lewis
Assistant Inspector General
Evaluation, Inspection and Management Services

SUBJECT: Review of Lender Inducements (ED/OIG I13C0003)

This alert memorandum provides information from our review of lender inducements. The Office of Inspector General received an allegation that Sallie Mae was offering schools illegal inducements in return for Federal Family Education Loan Program (FFELP) loan volume. The allegation, from an anonymous source, did not include any specific information or evidence regarding illegal inducements.

The governing anti-inducement legislation, found in Section 435(d)(5)(A) of the Higher Education Act of 1965, as amended (HEA), prohibits a lender from offering, directly or indirectly, points premiums, payments, or other inducements, to any educational institution or individual in order to secure applicants for FFELP loans. Since the enactment of the legislation in 1986, the FFELP market has changed significantly with increasing demands for benefits or services by schools, the rising cost of education, and escalating competition for FFELP loans.

The Department's interpretive guidance to the community through Dear Colleague Letters has not been updated since 1995. Informal guidance provided in letters and e-mails has not resolved the concerns of the FFELP participants as to what constitutes an inducement. Formal administrative enforcement action has been limited to one case, involving Sallie Mae's agreement with Dr. William M. Scholl College of Podiatric Medicine. Federal Student Aid has never performed reviews of lenders for the specific purpose of reviewing compliance with the anti-inducement provision.

The Department held a series of meetings with the FFELP community in the spring and summer of 2001 to discuss anti-inducement issues, but no consensus was reached. In November 2001, the Consumer Bankers Association (CBA) and the Education Finance Council (EFC) issued a joint statement on their view of the applicability of the anti-

inducement statute to the private credit offerings of FFELP lenders. In the statement, CBA and EFC declared that they believe it is illegal for a lender to require a school to refer FFELP loan applicants (including placing a lender on a preferred lender list) to the lender in exchange for private credit. A FFELP lender, however, could offer private credit in hopes of FFELP loan referrals from a school, and could subsequently alter the terms of any private loan agreement with a school, or cease to provide private credit if the FFELP loan volume was less than expected.

Sallie Mae and the National Council of Higher Education Loan Programs did not sign the statement. The Department has not taken a position on the joint statement and has not offered guidance on the growing market for private loans.

We met with representatives from Federal Student Aid (FSA), the Office of the General Counsel, the Office of Postsecondary Education (OPE), and the Office of the Deputy Secretary. We also interviewed representatives from Sallie Mae and other FFELP participants, including lenders, guaranty agencies, a school financial aid officer participating in the William D. Ford Federal Direct Loan Program (Direct Loan Program) and a lawyer with the legal aid community representing student interests. Although the parties we interviewed were knowledgeable and provided useful information on current practices in the FFELP market, none provided specific information regarding improper inducements provided by lenders at specific institutions.

We selected two schools for review based on an increase in Sallie Mae loan volume. We found evidence that one of these schools and Sallie Mae negotiated preferred lender status in exchange for a specified dollar amount of private loans.

Our review concluded there are bargaining practices between schools and lenders for FFELP preferred loan status and private loan volume that should be addressed through statutory and regulatory changes or further Department guidance. Given the current marketing practices by schools and lenders, the Department should examine the roles and responsibilities of schools, as well as lenders and lender affiliates in the inducement issue.

We recommend that in recognition of the current market realities in the FFELP, the Assistant Secretary for OPE:

- Provide guidance on the growing market for private loans by clarifying the application of the anti-inducement provision to private loans; and

- Reevaluate the anti-inducement provision of Section 435(d)(5)(A) of the HEA and determine if statutory changes should be proposed in the upcoming reauthorization to include schools, lender affiliates and other necessary changes.

cc: John Danielson
Harold Jenkins

UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF INSPECTOR GENERAL

THE INSPECTOR GENERAL

JUN 2 3 2005

The Honorable Tom Davis
Chairman, Committee on Government Reform
U.S. House of Representatives
2157 Rayburn House Office Bldg.
Washington, D.C. 20515

The Honorable Henry Waxman
Ranking Member, Committee on
Government Reform
U.S. House of Representatives
B-350A Rayburn House Office Bldg.
Washington, D.C. 20515

Dear Chairman Davis and Congressman Waxman:

Thank you and your colleagues on the Committee on Government Reform for inviting me to participate in the May 26th hearing on the Federal Family Education Loan (FFEL) and Direct Loan programs. I appreciated the opportunity to highlight the work my office has done in reviewing and making recommendations to the U.S. Department of Education (Department) on improving management and performance of these vital loan programs.

In response to Chairman Davis' questions regarding funds for administering student aid programs, my response addresses the question of oversight. While we have not conducted an audit targeted solely on expenditures of Section 458 of the Higher Education Act, we regularly conduct audits of activities and functions that may well be funded with Section 458 monies, among other sources. Our work has not focused on the source of expenditures, but rather the performance of expenditures.

To address Congressman Van Hollen's question regarding our work on lender inducements in 2003, enclosed is a copy of our August 2003 alert memorandum to the Department that included information from our review of lender inducements. In recognition of the current market realities in the FFEL program, we recommended that the Assistant Secretary for the Office of Postsecondary Education (OPE):

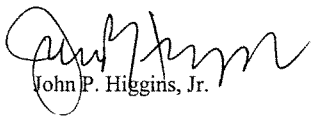
(1) Provide guidance on the growing market for private loans by clarifying the application of the anti-inducement provision to private loans; and

(2) Re-evaluate the anti-inducement provision of Section 435(d)(5)(A) of the Higher Education Act and determine if statutory changes should be proposed to include schools, lender affiliates and other necessary changes.

To our knowledge, OPE has not yet issued any guidance or proposed legislative changes that would address our recommendations. You may wish to contact Sally Stroup, Assistant Secretary for OPE, for additional information concerning any Department activities in this area.

Again, thank you for convening a hearing on this important issue. Please know my staff and I are available if you have any additional questions, or require more information.

Sincerely,



John P. Higgins, Jr.

Enclosure
cc: The Honorable Chris Van Hollen
Ms. Theresa S. Shaw, U.S. Department of Education
Ms. Sally Stroup, U.S. Department of Education
Ms. Deborah Price, U.S. Department of Education

House Committee on Government Reform
Oversight Hearing on Federal Student Loan Programs
May 26, 2005

FSA Responses to Member Questions

Mr. Shays: I want to know how the Department of Education recognizes or certifies foreign schools. Is there a list of foreign schools that are pre-qualified? How do you know they are for real? Do on-site visits result in your decertifying a school? Are there any cases that you decertified schools? Ms. Shaw commented that she would provide the numbers of schools decertified and schools never reaching application criteria.

Foreign schools represent less than one half of one percent ($305 million for 2003-2004) of all Title IV funding and are only eligible for Federal Family Education Loan (FFEL) funding. Students must be American citizens or eligible non-citizens to receive loans. In FY 2004, there were approximately 18,500 students receiving loans to attend foreign schools.

There are 509 eligible foreign schools receiving FFEL funds. In FY 2004, 77 schools had more than $500,000 in FFEL loan volume; 267 foreign schools had 10 or fewer loan recipients. The default rate for foreign schools was 2.6% in FY 2000, 2.3% in FY 2001 and 2.0% in FY 2002 compared to the national average of 5.9%, 5.4% and 5.2%, respectively.

I want to know how the Department of Education recognizes or certifies foreign schools.

Like domestic schools, foreign schools must apply and be deemed eligible to participate in the Title IV programs. Foreign schools must also meet financial responsibility and audit requirements. Foreign graduate medical schools have additional requirements. The Department maintains a Foreign Schools Team dedicated to monitoring and providing oversight to foreign schools.

Prior to approval to participate in the Title IV programs, the Department conducts an authentication review of each foreign school. This includes validating authentication through the Department's office of International Education. If the Department questions the authenticity of any school, it will refuse to grant eligibility to the school.

Additionally, the Department has placed more responsibility on Guaranty Agencies to assist foreign institutions with the administration of the FFEL programs.

Is there a list of foreign schools that are pre-qualified?
There is no pre-qualification status for participation in Title IV programs. All schools must apply and meet the approval requirements documented above to participate in Title IV programs.

Do on-site visits result in your decertifying a school?

The Department performs both on- and off-site reviews of schools, as needed. This process determines whether institutions meet regulatory requirements for eligibility, administrative capability and financial responsibility and ensures compliance with federal legislation, regulations and policy. Most program reviews result in technical assistance to help schools better understand program requirements. However, program reviews can result in the assessment of a liability or in some cases, a termination action.

Are there any cases that you decertified schools?

Schools that do not meet institutional eligibility criteria are denied continued participation or access to new participation in the programs. The following are examples of schools that did not meet eligibility requirements.

- **SABA Medical: New School application** – Not approved for participation due to program and medical school eligibility issues, financial issues and legal authorization issues.
- **The Chinese University of Hong Kong** – Denied certification due to refund policy.
- **Open University** – Not approved for participation due to institutional eligibility issue, offering only distance education.

Mr. Davis: How much money do you lose annually, in direct lending, on loans that are uncollected? Years 1998-2004

All Direct Loans remain as open receivables until the loan, interest and collection fees are paid. The Department recognizes a loss on a defaulted student loan when the debt is forgiven due to borrower death or permanent disability. If a borrower has not made payment for 270 days they are considered in a default status whereby interest continues to accrue and more rigorous collection activity occurs.

At the end of FY 2004, total defaulted Direct Loan debt (outstanding principal and interest) was $7.1 billion. From FY 2000 through FY 2004, FSA collected over $2.5 billion in defaulted Direct Loan debt and is expected to recover an additional $1.5 billion in FY 2005.

Mr. Davis: It is my understanding that most of the money for administering student aid programs is money that is provided in an entitlement account. So the salaries and expenses are considered entitlement spending. Is this true? In other words, if the President's budget makes a change in that, to move it to appropriated funds, you would have a ceiling under appropriated funds? Is this correct?

It is my understanding that mandatory administrative money is like a slush fund, if you do not spend it in one year, you roll it over and you can spend it in the next. Is there oversight on these expenditures?

Section 458 of the Higher Education Act provides mandatory funding to operate the Federal student aid programs. The Secretary allocates these funds to FSA and other Department offices with student aid-related responsibilities; in addition, a portion of these funds are used to pay statutory account maintenance fees to FFEL guaranty agencies. For example, section 458 funding in fiscal year 2005 totals $795 million, of which $195 million supports guaranty agency account maintenance fees.

While provided through a mandatory funding mechanism, Section 458 funds are treated as an annual appropriation in most respects. FSA must submit budget requests that are reviewed and adjusted by both Departmental senior officers and by OMB. FSA must then operate under the approved budget without exceeding approved amounts. In summary, FSA's budget for administration is controlled; funds generally can only be used in the fiscal year for which they were approved; and spending is subject to all controls normally associated with an agency's budget and expenditure authority. While FSA does not have a limit on staff FTE, it must manage salary (and salary overhead) dollars and all other object class categories as if it has an annual limit on total administrative funds. Therefore, in response to one of Mr. Davis' specific questions, there already is a "ceiling" in FSA's budget, regardless of any budgetary changes proposed in the President's budget.

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