



April 2018

FEDERAL STUDENT LOANS

Actions Needed to Improve Oversight of Schools' Default Rates

GAO Highlights

Highlights of [GAO-18-163](#), a report to congressional requesters

Why GAO Did This Study

As of September 2017, \$149 billion of nearly \$1.4 trillion in outstanding federal student loan debt was in default. GAO was asked to examine schools' strategies to prevent students from defaulting and Education's oversight of these efforts.

This report examines (1) how schools work with borrowers to manage default rates and how these strategies affect borrowers and schools' accountability for defaults; and (2) the extent to which Education oversees the strategies schools and their default management consultants use to manage schools' default rates. GAO analyzed Education data on student loans that entered repayment from fiscal years 2009–2013, the most recent data at the time of this analysis; reviewed documentation from Education and a nongeneralizable sample of nine default management consultants selected based on the number of schools served (about 1,300 schools as of March 2017); reviewed relevant federal laws and regulations; and interviewed Education officials.

What GAO Recommends

Congress should consider strengthening schools' accountability for student loan defaults and requiring that the information schools and consultants provide to borrowers about loan repayment and postponement options be accurate and complete. GAO recommends that Education increase transparency of reporting on default rate sanctions. Education agreed with our recommendation.

View [GAO-18-163](#). For more information, contact Melissa Emrey-Arras at (617) 788-0534 or emreyarrasm@gao.gov.

April 2018

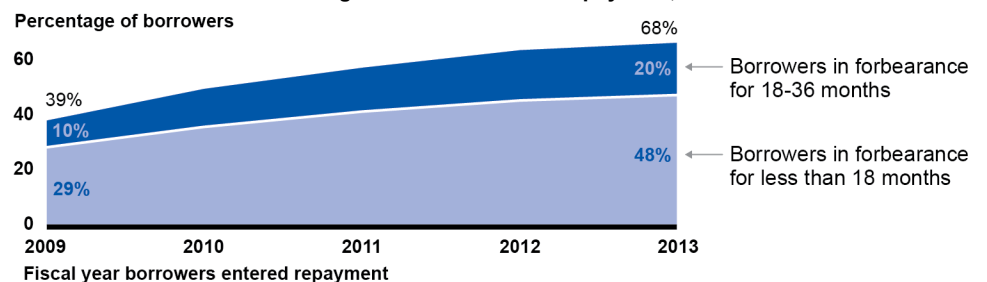
FEDERAL STUDENT LOANS

Actions Needed to Improve Oversight of Schools' Default Rates

What GAO Found

According to federal law, schools may lose their ability to participate in federal student aid programs if a significant percentage of their borrowers default on their student loans within the first 3 years of repayment. To manage these 3-year default rates, some schools hired consultants that encouraged borrowers with past-due payments to put their loans in forbearance, an option that allows borrowers to temporarily postpone payments. While forbearance can help borrowers avoid default in the short-term, it increases their costs over time and reduces the usefulness of the 3-year default rate as a tool to hold schools accountable. At five of the nine selected default management consultants (that served about 800 of 1,300 schools), GAO identified examples when forbearance was encouraged over other potentially more beneficial options for helping borrowers avoid default, such as repayment plans that base monthly payments on income. Based on a review of consultants' communications, GAO found four of these consultants provided inaccurate or incomplete information to borrowers about their repayment options in some instances. A typical borrower with \$30,000 in loans who spends the first 3 years of repayment in forbearance would pay an additional \$6,742 in interest, a 17 percent increase. GAO's analysis of Department of Education (Education) data found that 68 percent of borrowers who began repaying their loans in 2013 had loans in forbearance for some portion of the first 3 years, including 20 percent that had loans in forbearance for 18 months or more (see figure). Borrowers in long-term forbearance defaulted more often in the fourth year of repayment, when schools are not accountable for defaults, suggesting it may have delayed—not prevented—default. Statutory changes to strengthen schools' accountability for defaults could help further protect borrowers and taxpayers.

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



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

Education's ability to oversee the strategies that schools and their consultants use to manage their default rates is limited. Education's strategic plan calls for protecting borrowers from unfair and deceptive practices; however, Education states it does not have explicit statutory authority to require that the information schools or their consultants provide to borrowers after they leave school regarding loan repayment and postponement be accurate and complete. As a result, schools and consultants may not always provide accurate and complete information to borrowers. Further, Education does not report the number of schools sanctioned for high default rates, which limits transparency about the 3-year default rate's usefulness for Congress and the public.

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Abbreviations

CDR	Cohort Default Rate
Direct Loan program Education	William D. Ford Federal Direct Loan Program U.S. Department of Education
NSLDS	National Student Loan Data System

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April 26, 2018

The Honorable Rosa DeLauro
Ranking Member
Subcommittee on Labor, Health and Human Services,
Education, and Related Agencies
Committee on Appropriations
House of Representatives

The Honorable Mark Takano
House of Representatives

Over 42 million borrowers held nearly \$1.4 trillion in federal student loans as of September 2017 through programs authorized under Title IV of the Higher Education Act of 1965, as amended.¹ Of that amount, loans valued at \$149 billion, or about 11 percent of the total, were in default, posing a financial risk to the federal government and taxpayers. The Department of Education (Education) can rescind a school's eligibility to participate in federal student aid programs if a certain percentage of their student loan borrowers default on their loans within a certain time period.² Education calculates a cohort default rate (CDR)—the percentage of borrowers who enter repayment in a given fiscal year who then default within a 3-year period—for each school to hold them accountable for high default rates.³

The CDR, however, may have limitations as an oversight tool. News reports indicate that some schools and the consultants they hire to provide default management services may use strategies to prevent borrowers from defaulting during the CDR period that are not in borrowers' best interests. Specifically, these sources reported that schools and their consultants may counsel past-due borrowers to postpone their monthly payments by putting their loans in forbearance when other repayment options may be more favorable for some

¹ Pub. L. No. 89-329, 79 Stat. 1219, 1232, codified as amended at 20 U.S.C. §§ 1070-1099d.

² Specifically, Education generally penalizes schools if their default rate is 30 percent or above for 3 consecutive years or above 40 percent in a single year.

³ For the purpose of calculating cohort default rates, Education identifies defaulted loans as those whose payments are 360 days or more past due. 34 C.F.R. § 668.202.

borrowers.⁴ Student loan experts have raised concerns that this strategy may harm borrowers and undermine the effectiveness of the CDR to hold schools accountable. You asked us to review this issue.

For this report, we examined (1) how schools work with borrowers to manage schools' cohort default rates, and how these strategies affect borrowers and schools' accountability for defaults, and (2) the extent to which Education oversees the strategies schools and their default management consultants use to manage schools' cohort default rates and informs the public about its efforts to hold schools accountable.

To determine how schools work with borrowers to manage their CDRs, we examined the practices of selected companies that schools contract with for this purpose. Specifically, we selected a nongeneralizable sample of nine default management consultants that served over 1,300 schools.⁵ These schools accounted for over 1.5 million borrowers in the 2013 CDR cohort. We reviewed documentation from these default management consultants on the schools they work with and the strategies they use to reduce borrower defaults. We interviewed management officials and employees responsible for contacting and working with borrowers at four of these companies.⁶ We also analyzed school-level data from Education's National Student Loan Data System (NSLDS), Education's central database for federal student aid information, for the five most recent CDR cohorts for which data are available, from cohort years 2009 to 2013, to analyze trends in loan postponement, repayment, and

⁴ Forbearance is a period during which student loan interest continues to accrue but monthly payments are temporarily postponed or reduced.

⁵ To select these nine consultants, we obtained information from Education on 48 default management consultants that self-reported they provided default management services to schools as of December 2016. We prioritized selection of consultants with large numbers of client schools, those with a specific focus on default management, or those with unique default management practices based on our review of their websites.

⁶ To select the four consultants for interviews, we prioritized selection of consultants that provided default management services to large numbers of client schools or had unique default management practices.

default.⁷ For the same CDR periods, we analyzed 3-year repayment rate data from Education's College Scorecard and CDRs from Education's CDR Database.⁸ We also compared the effect postponement of student loans has on the CDR by calculating an alternative metric. We assessed the reliability of the data we obtained from Education by reviewing documentation and testing the data we used in this report. We determined the data to be sufficiently reliable for the purposes of this report. We also interviewed representatives from higher education associations, the Consumer Financial Protection Bureau, a state attorney general's office, and consumer advocates.⁹ We reviewed relevant provisions in the Higher Education Act of 1965, as amended. In addition, we assessed the CDR against government standards for internal control for identifying and responding to risks and goals and objectives in the Office of Federal Student Aid's Fiscal Year 2015-2019 Strategic Plan.

To determine the extent to which Education oversees the strategies schools and their default management consultants use to manage schools' CDRs and informs the public about its efforts to hold schools accountable, we reviewed relevant federal laws and regulations and Education's internal guidance and documentation on calculating, assessing, and overseeing CDRs. We interviewed Education officials responsible for oversight of student financial aid, including the CDR and default prevention. We assessed Education's oversight activities against goals and objectives in the Office of Federal Student Aid's Fiscal Year 2015-2019 Strategic Plan, government standards for internal control for communicating with stakeholders, and Office of Management and Budget

⁷ CDR cohorts are measured by federal fiscal year. For example, the 2013 CDR cohort includes borrowers who entered repayment from October 1, 2012 to September 30, 2013. The 2009 CDR cohort was the first cohort for which schools were held accountable for a 3-year CDR, and the 2013 CDR cohort was the most recent available at the time of our analysis. While about 6,000 schools participate in federal student aid programs, some may be grouped together for purposes of calculating the CDR, such as schools that have branch campuses and for-profit schools owned by the same company. Our analysis was based on the population of 4,138 schools that had a CDR calculated for 2013. We excluded schools whose CDR was calculated using a different formula that Education uses for schools with fewer than 30 borrowers entering repayment in a particular cohort.

⁸ The 3-year repayment rate measures the percentage of a school's borrowers who are not in default on their federal student loans and who paid down at least \$1 of the principal loan amount during the first 3 years of repayment.

⁹ The Consumer Financial Protection Bureau was created in 2010 to regulate the offering and provision of consumer financial products or services, such as student loans, under federal consumer financial laws. Pub. L. No. 111-203, § 1011(a), 124 Stat. 1376, 1964 (2010).

guidelines for disseminating public information. More details on our scope and methodology are included in appendix I.

We conducted this performance audit from May 2016 to April 2018, in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

Direct Loan Program

Education administers federal student financial aid programs, including the William D. Ford Federal Direct Loan (Direct Loan) program, through the Office of Federal Student Aid.¹⁰ Education issues several types of loans under the Direct Loan program, including subsidized and unsubsidized loans. Prospective borrowers apply and are approved for loans through Education, which then disburses the loan through the borrowers' school. Upon disbursement of funds, Education assigns each loan to a contracted loan servicer responsible for communicating information to borrowers while they are in school and when they enter repayment. Borrowers receive additional information about their loans and related rights and responsibilities through their loan's promissory note, Education's website, and mandatory entrance and exit counseling provided by their school.¹¹ When borrowers enter repayment, generally 6

¹⁰ Until 2010, many federal student loans were originated by private lenders and servicers through the Federal Family Education Loan program. Under the Direct Loan program, the federal government directly disburses funds to borrowers.

¹¹ Schools must generally provide entrance counseling to first-time borrowers before the first disbursement of the loan. Schools generally must provide exit counseling before a student leaves school. Entrance and exit counseling include information on the consequences of default. Exit counseling specifically provides borrowers information about available repayment options and debt management strategies. See 20 U.S.C. § 1092(l) and 34 C.F.R. § 685.304(a) for entrance counseling requirements and 20 U.S.C. § 1092(b) and 34 C.F.R. § 685.304(b) for exit counseling requirements.

months after leaving school, they make payments directly to the assigned servicer.¹²

Federal Student Loan Repayment and Postponement Options

Education offers a variety of repayment plan options that can help Direct Loan borrowers avoid delinquency and default, including Standard, Graduated, Extended, and Income-Driven.¹³ Income-Driven Repayment plans can ease repayment by setting loan payment amounts as a percentage of a borrower's income and extending the repayment period up to 25 years.¹⁴ Unlike Standard, Graduated, and Extended repayment plans, Income-Driven Repayment plans offer loan forgiveness at the end of the repayment term and monthly payments may be as low as \$0 for some borrowers.¹⁵ Extending the repayment period may also result in

¹² Borrowers are not required to make loan payments when they are enrolled in school at least half-time or during the grace period—usually 6 months after leaving school. For subsidized loans, which are only available to undergraduate students, borrowers are generally not responsible for paying interest on the loans while in school, during the 6-month grace period, and during periods of authorized deferment (during which borrowers can temporarily suspend repayment, if for example, they pursue additional higher education, provide military service, or experience economic hardship). For unsubsidized loans, which are available to undergraduate and graduate students, borrowers are responsible for all interest charges. The Direct Loan program also offers PLUS loans to graduate and professional degree students and parents of dependent undergraduate students. Borrowers are responsible for paying the interest that accrues on PLUS loans. Direct Consolidation loans allow borrowers to combine multiple existing federal student loans into a single loan with one interest rate and one monthly payment.

¹³ Under the Standard plan, borrowers generally owe fixed monthly payments over a fixed term of 10 years. Borrowers are automatically enrolled in the Standard plan if they do not choose another option. Under the Graduated plan, borrowers' payments are initially lower than they would be under the Standard plan, but increase every 2 years, for up to 10 years. Under the Extended plan, borrowers' terms are fixed at 25 years or less. Monthly payments under this plan may be fixed or graduated, and borrowers must have more than \$30,000 in loans to qualify.

¹⁴ Income-Driven Repayment includes the following plans: Income-Contingent Repayment, Pay As You Earn, Revised Pay As You Earn, and Income-Based Repayment plans. The repayment period for these plans is generally either 20 or 25 years.

¹⁵ Monthly payments for Income-Driven Repayment plans are generally set as a proportion of the borrower's discretionary income, which is assessed annually and defined as adjusted gross income exceeding 100 percent of the federal poverty guideline for the Income-Contingent Repayment plan, and 150 percent of the guideline for all other plans. Borrowers on Income-Contingent Repayment pay \$0 if the monthly payment amount calculated is \$0, and borrowers on Income-Based Repayment, Pay As You Earn, and Revised Pay As You Earn pay \$0 if the monthly payment calculated is less than \$5. Under current tax law any amount forgiven under Income-Driven Repayment plans is subject to federal income tax.

some borrowers paying more interest over the life of the loan than they would under 10-year Standard repayment. In addition to making monthly payments more manageable and offering the potential for loan forgiveness, Income-Driven Repayment plans may also reduce the risk of default. For example, in 2015, we reported that borrowers in two such plans had substantially lower default rates than borrowers in the Standard repayment plan.¹⁶

Eligible borrowers may also temporarily postpone loan payments through deferment or forbearance. Several different types of deferment are currently available to borrowers, each with their own eligibility criteria.¹⁷ Under deferment, the interest generally does not accrue on subsidized loans, but it continues to accrue on unsubsidized loans. Eligible borrowers can also postpone or reduce loan payments through either a general or mandatory forbearance; however, interest on the loan continues to accrue in each type (see table 1).¹⁸ Most borrowers choose general forbearance, which, unlike most types of mandatory forbearance and deferment, can be issued over the phone with no supporting documentation.¹⁹ As of September 2017, \$69.9 billion in outstanding Direct Loans was in general forbearance compared to \$6.3 billion in mandatory forbearance, according to Education data.

¹⁶ See GAO, *Federal Student Loans: Education Could Do More to Help Ensure Borrowers Are Aware of Repayment and Forgiveness Options*, [GAO-15-663](#) (Washington, D.C.: Aug. 25, 2015).

¹⁷ An in-school deferment, available to eligible borrowers who are pursuing additional higher education, is the most commonly used type of deferment.

¹⁸ Borrowers typically choose to postpone rather than reduce loan payments, according to Education officials. Loan servicers can also apply administrative forbearances under certain conditions, such as to cover the transition period while they collect and process documentation supporting the borrower's request for a change in repayment plan. Education officials stated that administrative forbearances are only used for short periods of time, typically less than 60 days. As of September 2017, \$36.3 billion in outstanding Direct Loans was in administrative forbearance.

¹⁹ Several different types of mandatory forbearance are available. For example, borrowers participating in certain teaching services or serving in certain medical or dental residency programs, AmeriCorps, or the National Guard are eligible for mandatory forbearance.

Table 1: Key Characteristics of Direct Loan Payment Postponement Options

	General Forbearance	Mandatory Forbearance	Deferment
What are the eligibility criteria? ^a	None; eligibility is granted at the discretion of the loan servicer, which may base eligibility on any reason acceptable to the loan servicer, such as borrower financial difficulties.	Must be granted by the loan servicer if the borrower meets the eligibility requirements, such as serving in certain medical or dental residency programs, AmeriCorps, or the National Guard.	Must be granted if the borrower meets the eligibility requirements, such as enrolled at least half-time in school, in certain active duty military service, or unemployed.
How long can borrower remain in status?	Borrowers can remain in forbearance for up to 12 months before they have to reapply. There are no limits on the total amount of time a borrower can spend in general forbearance as long as they do not exceed 36 consecutive months in general forbearance. ^b	For most mandatory forbearance types, eligibility can be renewed as long as the borrower continues to meet the eligibility requirements. ^c	For most deferment types, eligibility can be renewed as long as the borrower continues to meet the eligibility requirements. ^c
Is supporting documentation required?	No; borrowers can attest to their need over the phone with no supporting documentation.	Yes; supporting documentation is generally required. ^d	Yes; supporting documentation is generally required. ^d
Does interest continue to accrue?	Yes.	Generally yes.	Sometimes; for example, it does not accrue on subsidized loans, but it continues to accrue on unsubsidized loans.

Source: GAO analysis of relevant federal laws, regulations, and Department of Education (Education) guidance. | GAO-18-163

^aEligibility is assessed once the borrower requests a general forbearance, mandatory forbearance, or deferment.

^bIf they choose to do so, loan servicers may set a limit below 12 months for the maximum period of time they grant for each general forbearance.

^cEligibility for deferment based on unemployment or economic hardship and eligibility for mandatory forbearance based on student loan debt burden is generally capped at 3 years.

^dThe supporting documentation required differs depending on the type of mandatory forbearance or deferment. For example, a mandatory forbearance based on burden of student loan debt requires submission of income documentation, such as a tax return. Loan servicers may be able to verify eligibility through Education’s central database for federal student aid information with no additional documentation provided by borrowers for some types of mandatory forbearance and deferment, according to Education officials. Additionally, some borrowers who qualify for unemployment deferment can attest to their need with no supporting documentation.

Cohort Default Rate Calculation

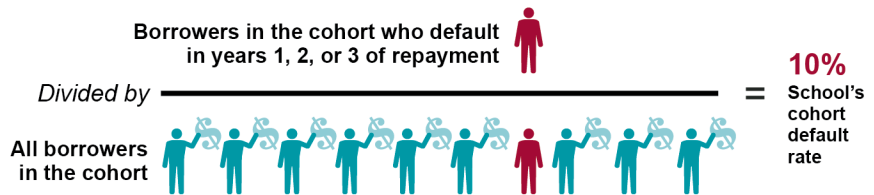
Education computes CDRs each year for all schools that enroll students who receive funds through the Direct Loan program.²⁰ To compute a school's CDR, Education divides the number of student loan borrowers in a CDR cohort—those entering repayment in the same fiscal year—who have defaulted on their loans in the initial 3 years of repayment by the total number of a school's student loan borrowers in that CDR cohort (see fig. 1).²¹ The CDR does not hold schools accountable for borrowers who default after the 3-year period.²² Borrowers in deferment and forbearance are considered to be “in repayment” and current on their loans for the purpose of calculating a school's CDR, even though borrowers in these loan statuses are not expected to make any monthly payments.

²⁰ Direct Loans included in the CDR calculation include Subsidized and Unsubsidized Stafford Loans. Subsidized and Unsubsidized Stafford Loans disbursed under the Federal Family Education Loan Program prior to July 2010 are also included in the CDR calculation for schools. The calculation does not include PLUS Loans or loans made under the Federal Perkins Loan program, which has its own CDR calculation and consequences. Under the Federal Perkins Loan program, no new loans were permitted to be made after September 30, 2017.

²¹ Repayment generally refers to the period in which borrowers are responsible for repaying their loan(s). Repayment typically begins after a 6-month grace period after a student drops below half-time enrollment, graduates, or leaves school. CDRs are based on the number of borrowers who enter repayment in a given fiscal year; a borrower with multiple loans entering repayment in the same fiscal year from the same school will be included in the formula only once.

²² Education also annually reports lifetime default rates. The Cumulative Lifetime Default Rate is the percentage of Stafford, PLUS, Grad PLUS, and consolidation loans that entered repayment in the Federal Family Education Loan and Direct Loan programs during a particular federal fiscal year and defaulted through the end of the most recent fiscal year. The Budget Lifetime Default Rate for a particular cohort reflects the default rate and percentage of dollars estimated to go into default over the life of the loans. These rates are significantly higher than the 3-year CDR because they cover a longer time period. For example, the estimated Budget Lifetime Default Rate for the 2017 cohort of Direct Loans ranges from 7.8 percent for Unsubsidized Stafford Loans (graduate) to 26.9 percent for Unsubsidized Stafford Loans (undergraduate). The lifetime default rates are not calculated for schools and are not intended as an accountability metric for schools.

Figure 1: Example of School Cohort Default Rate Calculation



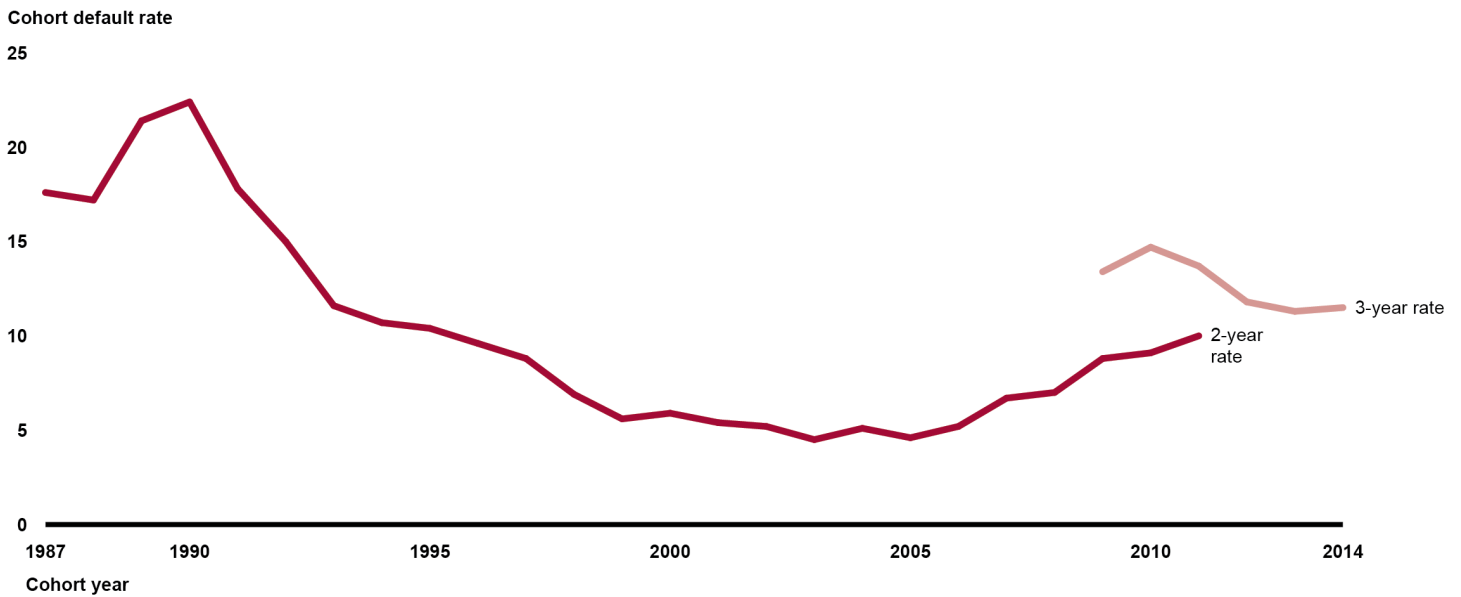
Source: GAO analysis of U.S. Department of Education information. | GAO-18-163

Note: For the cohort default rate calculation, a cohort includes borrowers who enter repayment in the same fiscal year. For example, the 2014 cohort includes borrowers who enter repayment in fiscal year 2014 (October 1, 2013 to September 30, 2014).

For the 2014 CDR cohort, the national 3-year CDR was 11.5 percent, meaning 11.5 percent of borrowers who first entered repayment in fiscal year 2014 had defaulted on one or more loans by the end of fiscal year 2016. The national CDR has changed over time, peaking at 22.4 percent for the 1990 CDR cohort and declining to a historic low of 4.5 percent for the 2003 CDR cohort (see fig. 2). Beginning with the 2009 CDR cohort, Education switched from a 2-year measurement to a 3-year measurement as required by the Higher Education Opportunity Act.²³

²³ See Pub. L. No. 110-315, § 436(e), 122 Stat. 3078, 3256 (2008).

Figure 2: Cohort Default Rate Trends, Cohort Years 1987–2014



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

Note: Education issued the first cohort default rates (CDR) for the 1987 cohort. Prior to the 2009 cohort, Education calculated 2-year CDRs, after which they calculated 3-year CDRs. During the transition period, Education calculated estimates of both time periods.

According to Education officials, there are several possible explanations for the general decrease in the national CDR from the 1990 cohort to the 2003 cohort. They include: 1) Education’s efforts to provide schools with default prevention training; 2) the loss of eligibility to participate in federal student aid programs and subsequent closure of many schools with chronically high CDRs in the early 1990s; 3) enactment of legislation in 1998 that increased the length of time a loan can go unpaid before being considered in default, which decreased the likelihood that a borrower would default within the CDR period;²⁴ and 4) an increase in borrowers

²⁴ For the purpose of calculating CDRs, Education now identifies defaulted loans as those whose payments are 360 days or more past due. As a result, borrowers past due on their loans for fewer than 360 days can avoid default if they begin making payments or postpone loan payments through forbearance or deferment.

consolidating their loans while in school, an option that was eliminated in 2006.²⁵

Use of the Cohort Default Rate to Hold Schools Accountable

Schools with high CDRs may lose eligibility to participate in federal student aid programs. Specifically, Education generally excludes schools from participation in the Direct Loan program if their CDR is above 40 percent for a single year and from participation in the Direct Loan and Federal Pell Grant programs if their CDRs are 30 percent or greater for 3 consecutive years.²⁶ Schools potentially subject to these sanctions can pursue an appeal.²⁷ The CDR is the only borrower outcome measure used to determine eligibility for participation in federal student aid programs for all schools.

Schools with high CDRs that do not cross these thresholds may also be subject to additional oversight. For example, schools are certified for up to 6 years to maintain eligibility to participate in federal student aid, but schools with high CDRs may only be granted certification for 2 years, according to Education policy.²⁸ Education policy also prioritizes selection of schools with high CDRs for program review.²⁹ Further, schools whose CDRs are equal to or exceed 30 percent for any cohort are required to create a Default Prevention Taskforce that develops and submits a

²⁵ In-school consolidations counted borrowers' time in school as part of the CDR period. As a result, these borrowers were much less likely to default during the CDR period than other borrowers because they were eligible for in-school deferments that covered most of the CDR period, according to Education officials.

²⁶ Sanctioned schools lose program eligibility for the remainder of the fiscal year in which the school is notified of its sanction and for the following 2 fiscal years. Pell Grants are awarded to undergraduate students with financial need to help finance their postsecondary education. Schools that maintain CDRs below 15 percent for 3 consecutive cohorts are rewarded with fewer restrictions regarding their disbursement of federal student loans.

²⁷ There are six types of appeals and one adjustment available to schools subject to sanction; we refer to these collectively in this report as appeals.

²⁸ Through its certification process, Education reviews schools to ensure that they are administratively and financially capable of providing the education they promise and of administering Title IV program grants and loans in compliance with requirements.

²⁹ Education conducts program reviews to confirm that a school complies with Department requirements for institutional eligibility, financial responsibility, and administrative capability. The Higher Education Act of 1965, as amended, requires that the Department develop a system to prioritize program reviews based on high CDRs and dollars in default, among other risk factors.

default prevention plan to Education to reduce defaults, among other things.³⁰

Consequences of Student Loan Defaults

When borrowers do not make payments on their federal student loans, and the loans are in default, the federal government and taxpayers are left with the costs. Borrowers also face severe financial burdens when their federal student loans go into default. For example, upon default the entire unpaid balance of the loan and any accrued interest is immediately due. The amount owed may increase due to late fees, additional interest, and costs associated with the collection process, including court costs, collection fees, and attorney's fees.³¹ The federal government also has tools to collect on defaulted student loans. For example, under the Treasury Offset Program, the federal government can withhold certain federal or state payments to borrowers, including federal or state income tax refunds and some Social Security benefits, to collect on defaulted student loans.³² The federal government can generally also garnish up to 15 percent of a defaulted borrower's disposable pay and apply those funds toward the defaulted loan. There is no limit on how long the government can attempt to collect on defaulted student loans, and

³⁰ These default prevention plans must identify the factors causing a school's high default rate, establish measurable objectives and the steps the school will take to improve its CDR, and specify the actions the school will take to improve student loan repayment. 34 C.F.R. § 668.217.

³¹ Defaulted loans will appear on the borrower's credit record, which may make it more difficult for the borrower to obtain other loans and could also harm their ability to obtain a job or rent an apartment. Defaulted borrowers may also be ineligible for assistance under federal loan programs and may not receive any additional federal student aid until the loan is repaid in full or the borrower resolves the default through other means, such as loan consolidation or loan rehabilitation. Defaulted borrowers who enter into a loan rehabilitation agreement can restore their eligibility for federal student aid after making six on-time monthly payments and get their loans out of default after making nine on-time monthly payments.

³² The Treasury Offset Program was established under the Debt Collection Improvement Act of 1996 to centralize the collection of federal nontax debt, including defaulted federal student loans, at the Department of the Treasury. GAO also previously reported that in fiscal year 2015 Education collected about \$4.5 billion on defaulted student loan debt, of which about \$171 million was collected through Social Security offsets. Supplemental Security Income benefits, which provide monthly cash assistance for eligible individuals with limited financial means, are exempt from offset. GAO, *Social Security Offsets: Improvements to Program Design Could Better Assist Older Student Loan Borrowers with Obtaining Permitted Relief*. [GAO-17-45](#) (Washington, D.C.: Dec. 19, 2016).

student loans are more difficult to eliminate in bankruptcy proceedings than other types of consumer debt.³³

Default Management Consultants

Some schools hire default management consultants to help them reduce their CDRs. Education classifies default management consultants as “third-party servicers” and generally has the authority to oversee the services they provide to schools and their students.³⁴ Schools are required to notify Education when they enter into, modify, or terminate a contract with a third-party servicer. Based on concerns that a significant number of schools had not reported information on the third-party servicers they use as required, Education issued guidance to remind schools of the requirement in January 2015.³⁵ In addition, Education requires third-party servicers to submit information about the services they provide to schools. As of June 2017, Education reported that it had information on 187 third-party servicers, including 48 that reported providing default management services. Schools must ensure that their third-party servicers, including default management consultants, comply with relevant federal regulations and program requirements.³⁶ Education also requires third-party servicers to submit an annual compliance audit report that covers the administration of the federal student aid related services they perform to determine compliance with applicable statutes, regulations, and policies.

³³ Student loans cannot be eliminated in bankruptcy proceedings unless the court finds that repayment would constitute an undue hardship on the borrower and the borrower’s dependents. 11 U.S.C. § 523(a)(8).

³⁴ Under Education’s regulations at 34 C.F.R. § 668.2, a third-party servicer is an entity or individual that enters into a contract with an eligible institution to administer any aspect of the institution’s participation in Title IV programs, including, but not limited to determining a student’s eligibility for Title IV funds and receiving, disbursing, or delivering Title IV funds to students. Not all third-party servicers provide default management services, and those that do may offer other services as well.

³⁵ U.S. Department of Education, Office of Postsecondary Education, *Third-Party Servicer Institutional Requirements and Responsibilities*, GEN-15-01 (Washington, D.C.: Jan. 9, 2015).

³⁶ Schools may be fined or have their eligibility to participate in federal student aid programs suspended or terminated if their consultants violate relevant regulations or requirements. 34 C.F.R. §§ 668.84, 668.85, 668.86.

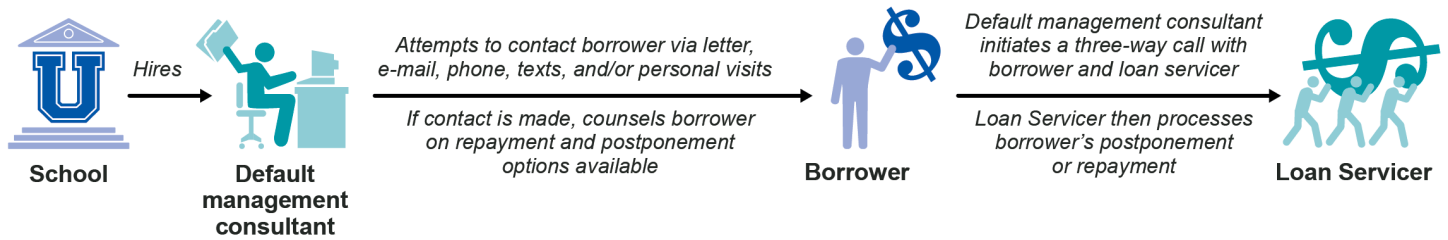
Some Schools' Consultants Encourage Borrowers to Postpone Loan Payments, Which Can Lower Cohort Default Rates and Increase Borrowers' Loan Costs

Some Schools' Consultants Encourage Borrowers to Postpone Loan Payments When Better Borrower Options May be Available

To help manage their default rates, some schools hired default management consultants that encouraged borrowers with past-due student loans to postpone loan payments through forbearance, even when better borrower options may be available.³⁷ The nine default management consultants we selected, which served over 1,300 schools, used various methods to contact borrowers and attempted to connect them with their loan servicer for assistance (see fig. 3). Seven of the nine participated in three-way conference calls with the borrower and the loan servicer. Further, one consultant visited past-due borrowers at their home to provide in-person loan counseling and connect them to their loan servicer.

³⁷ Forbearance helps borrowers avoid default because it brings past-due loans current (meaning zero days past due). Loans that are 360 days or more past due are considered to be in default for the purpose of calculating CDRs. Schools can also manage their CDRs by directly contacting their past-due borrowers to try to prevent them from defaulting on their loans without the assistance of a consultant.

Figure 3: Example Process for Schools that Hire Default Management Consultants to Contact Student Loan Borrowers during the 3-Year Cohort Default Rate Period



Source: GAO analysis of interviews with default management consultants and related documentation. | GAO-18-163

Among the nine consultants, we found some examples when repayment and postponement options were presented to borrowers neutrally or forbearance was presented as a last resort. However, we also identified examples from five of the consultants—which served about 800 schools—when forbearance was encouraged over other options that may have been more beneficial to the borrower, such as Income-Driven Repayment plans (see sidebar) or Extended or Graduated repayment plans.³⁸ These examples include practices that were still in use at the time of our review and those that consultants reported they previously used but have since discontinued. We included ongoing and discontinued practices in our review to illustrate the types of strategies that consultants have used to help schools manage their CDRs since Education began holding schools accountable for a 3-year CDR in fiscal year 2009 and to provide insight about the potential impact these strategies may have had on some borrowers. Of these five consultants:

³⁸ These schools accounted for over 875,000 borrowers in the 2013 CDR cohort. According to Education officials, not all borrowers are eligible for Income-Driven Repayment plans, and in some cases borrowers may find that their monthly payments would be lower on the Extended or Graduated repayment plans. Borrowers may also be able to lower their monthly payment through loan consolidation. Education provides a calculator on its website that allows borrowers to estimate monthly loan payments and total loan costs under different repayment plans.

Income-Driven Repayment Plans May Be Better Options for Some Struggling Borrowers

According to Education, postponing payments through forbearance may be appropriate for some borrowers who face temporary hardships. On the other hand, Income-Driven Repayment plans may be a better option for borrowers who are having difficulty repaying their loans for an extended period of time.

These plans base monthly payments on income and family size, and payments may be as low as \$0 for those who qualify. Income-Driven Repayment plans also feature the potential for forgiveness of remaining loan balances after 20 or 25 years of repayment.

Interest generally continues to accrue on loans in both forbearance and Income-Driven Repayment. Under forbearance, accumulated interest that is not paid during the forbearance period will generally be added to the loan balance, resulting in higher monthly payments when forbearance ends. In contrast, the federal government does not charge the unpaid interest for up to 3 years for some borrowers repaying their loans on Income-Driven Repayment plans, and struggling borrowers on these plans are not generally expected to make higher monthly payments until their financial situation improves.

In addition, GAO's past work found that borrowers in Income-Driven Repayment had substantially lower rates of default than those in Standard repayment.

GAO previously found that it is difficult for Education to estimate which borrowers have incomes low enough to benefit from or be eligible for Income-Driven Repayment plans because only borrowers who apply for these plans are required to submit income information to Education.

Source: GAO analysis of Department of Education information, [GAO-17-22](#), and [GAO-15-663](#). | GAO-18-163

- Four consultants sent borrowers who were past due on their loans unsolicited emails and letters that included only a forbearance application and instructed borrowers to return the application to them instead of their loan servicer.³⁹ Representatives of one consultant said that this practice was to ensure that borrowers completed the forms accurately. According to Education, the application provides an opportunity for borrowers to learn about other repayment and postponement options and the potential costs of forbearance. The application includes a statement informing borrowers about the option to request a deferment or Income-Driven Repayment plan and examples of the additional costs borrowers may incur as a result of interest that continues to accrue during forbearance. While this is correct, the application does not include details about these options; instead, it directs borrowers to Education's website for more information. Borrowers who only receive a forbearance application may inaccurately assume that forbearance is their only or preferred option. Moreover, borrowers may miss the opportunity to learn about other, potentially more favorable repayment and postponement options from Education's loan servicers, who are responsible for counseling borrowers and approving forbearance requests.
- One consultant included an inaccurate statement in letters it sent to borrowers who were past due on their loans. This consultant sent past-due borrowers forbearance applications with letters that inaccurately stated that the federal government can take away Supplemental Nutrition Assistance Program and Supplemental Security Income benefits when borrowers default on a federal student loan.⁴⁰ Inaccurate information about the consequences of default could cause a borrower who depends on these benefits to feel undue pressure to choose forbearance, even when eligible for more favorable repayment and postponement options.⁴¹ Further, this

³⁹ In the emails and letters that included a forbearance application, one consultant also suggested making a loan payment as an option. One other consultant reported that it stopped contacting borrowers on behalf of schools in 2016.

⁴⁰ According to officials at the U.S. Department of Agriculture, which administers the Supplemental Nutrition Assistance Program—previously known as the Food Stamp Program—benefits cannot be reduced due to borrowers defaulting on federal student loans. Similarly, according to Social Security Administration officials, Supplemental Security Income benefits, which provide cash assistance for eligible low-income individuals, cannot be reduced due to borrowers defaulting on federal student loans.

⁴¹ Deferment may be a more favorable postponement option for eligible borrowers with subsidized loans because the interest generally does not accrue on these loans during periods of deferment.

consultant's script for its representatives to use when calling borrowers who are past due on their loans referred exclusively to postponing loan payments. The script instructed representatives to tell borrowers "I am now going to conference you in with your loan servicer and they will process your forbearance over the phone." Borrowers who hear such statements may feel undue pressure to choose forbearance. The script also instructed representatives to tell the loan servicer that the borrower they were about to speak with was requesting a forbearance. Further, representatives from this consultant were also instructed to tell borrowers to "stick to their guns" on the option they have selected before connecting the borrower with their loan servicer on a three-way call.

- One consultant previously offered borrowers gift cards as an incentive to put their loans in forbearance.⁴² Education has also previously identified the use of gift cards to steer borrowers toward forbearance over other available options. An internal review that Education conducted in 2012 and 2013 found that a chain of schools used gift cards to promote forbearance for purposes of lowering its CDR. According to Education's findings, a borrower who had attended one of the schools stated that she was current in her payments but was offered a \$25 gift card to apply for forbearance. Multiple borrowers included in Education's review expressed the view that they were pressured or forced to apply for forbearance and were not made aware of other options, such as deferment or Income-Driven Repayment plans. Indeed, offering gift cards may steer borrowers toward forbearance over other available options. While the consultant that offered gift cards to borrowers to lower schools' CDRs has discontinued this practice, and the school Education reviewed has since closed, these practices may have affected reported CDRs and could be used by other consultants and schools.

Schools have a financial interest in preventing borrowers from defaulting within the first 3 years of repayment to ensure that their CDRs remain low enough to meet Education's requirements for participating in federal student aid programs.⁴³ Consultants also have a financial interest in

⁴² The consultant reported that it stopped offering gift cards in 2013 because its outreach was effective without offering them.

⁴³ Education generally sanctions schools by excluding them from participating in the Direct Loan program if their CDR is above 40 percent in a single year and from participating in the Direct Loan and Federal Pell Grant programs if their CDRs are 30 percent or greater for 3 consecutive years.

preventing borrowers from defaulting during the 3-year CDR period. Eight of the nine consultants we selected did not have any school clients that paid them to contact borrowers who were past due on their loans outside the 3-year CDR period. In addition, four of the nine selected consultants were paid by their client schools based on the number of past-due borrowers they brought current on their loans during the CDR period, and representatives' salaries or incentives at two of these consultants were calculated based on this as well.⁴⁴

Some consultants have an incentive to encourage forbearance in particular as a strategy to prevent borrowers from defaulting within the 3-year CDR period in an effort to lower their client schools' CDRs. This is because forbearance applications can be processed more quickly than other repayment or postponement options. Loan servicers can grant general forbearance based on a request from borrowers over the phone because there are no documentation requirements, whereas borrowers seeking deferment or an Income-Driven Repayment plan generally must submit a written application. According to Education officials, loan servicers are required to process Income-Driven Repayment plan applications within 15 business days. One consultant sent borrowers a letter that stated it could process a verbal forbearance in 5 minutes. The president of one school that contracted with a consultant that is paid based on the number of borrowers brought current told us that he did not care whether the consultant encouraged the use of forbearance as long as borrowers did not default within the 3-year CDR period and the consultant followed federal regulations. According to Education data, nearly 90 percent of the school's borrowers were in forbearance during the 2013 CDR period. Consultant payment structures, as well as the difference in processing requirements between forbearance, deferment, and Income-Driven Repayment plans may create incentives for consultants to encourage forbearance over other repayment and postponement options.

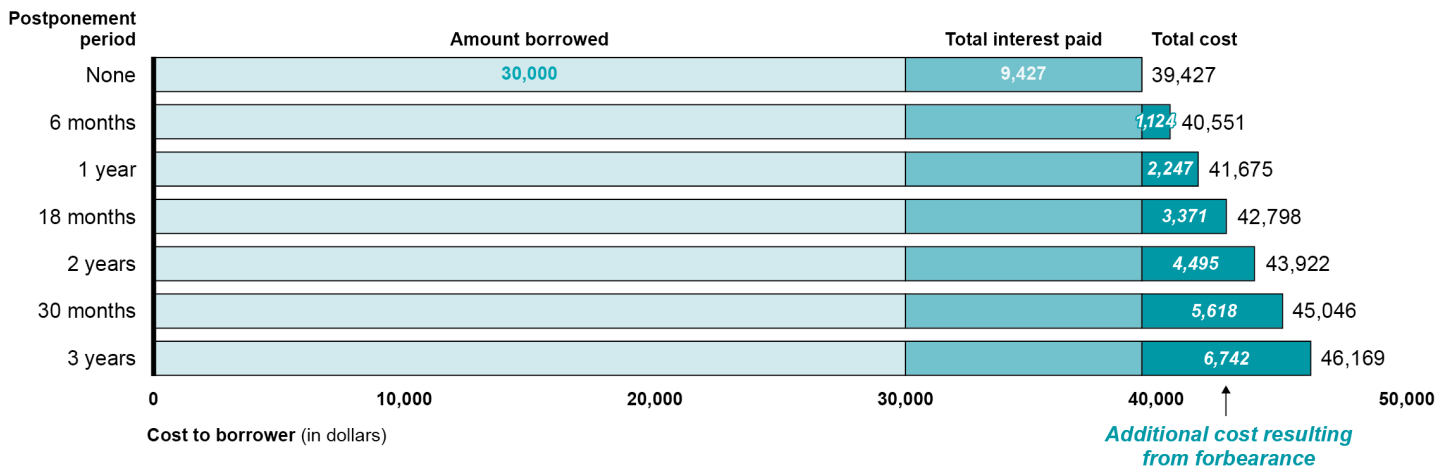
⁴⁴ One of these consultants made additional revenue from borrowers who relapsed into delinquency during the CDR period because the consultant charged schools each time past-due borrowers were brought current on their loans.

Postponing Loan Payments Can Increase Borrowers' Loan Costs and Reduce the Usefulness of the Cohort Default Rate to Hold Schools Accountable

While forbearance can be a useful tool for helping borrowers avoid defaulting on their loans in the short term, it increases their costs over time and reduces the usefulness of the CDR to hold schools accountable. To understand the potential financial impact of forbearance during the first 3 years of repayment (the CDR period), we calculated the cost for a borrower with \$30,000 in loan debt over 10 years in the Standard repayment plan with varying lengths of time in forbearance (see fig. 4).

Figure 4: Postponing Monthly Payments through Forbearance Increases Borrowers' Total Student Loan Costs

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



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

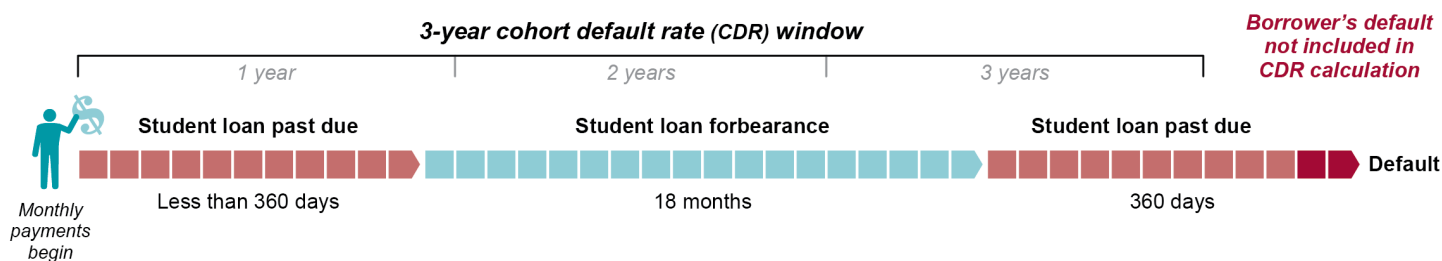
Note: GAO chose \$30,000 for the initial loan amount because it was the average outstanding loan balance per Direct Loan recipient as of the first quarter of fiscal year 2017. GAO chose 5.7 percent for the interest rate because it was the weighted average actual interest rate paid on fixed-rate loans that entered repayment in fiscal year 2013, the most recent year for purposes of calculating the cohort default rate at the time of GAO's analysis, according to school-level data from Education's National Student Loan Data System.

A borrower on the 10-year Standard repayment plan who did not spend any time in forbearance would pay \$39,427 over the life of the loan. Spending all 3 years of the CDR period in forbearance would cost that borrower an additional \$6,742, a 17 percent increase over spending no time in forbearance. One borrower we spoke with who took out \$34,700 in loans and opted for forbearance accrued about \$10,000 in interest in just over 3 years, an amount that the borrower said she would be paying off "for the rest of my days." Further, the unpaid interest that accrues while a borrower's loans are in forbearance may result in higher future monthly

payments when the forbearance period ends. Borrowers who cannot make these higher monthly payments may eventually default. If schools' consultants continue to encourage forbearance over other options that may be more beneficial, such as Income-Driven Repayment plans, some borrowers will continue to be at risk of incurring additional costs without any long-term benefits.

Education officials and student loan experts we spoke with said that forbearance is intended to be a short-term option for borrowers facing financial difficulties lasting a few months to a year, such as unexpected medical expenses. Longer periods of forbearance, while not typically advantageous to borrowers, can be an effective strategy for schools to manage their CDRs. Specifically, spending 18 months or more—at least half of the CDR period—in forbearance reduces the potential for borrowers to default within the 3-year period (see fig. 5). This is because forbearance keeps borrowers current on their loans, and borrowers would not go into default until they had made no payments for an additional 360 days after the forbearance period ended. Indeed, according to our analysis of Education's data for the 2013 CDR period, only 1.7 percent of borrowers who were in forbearance for 18 months or more defaulted within the 3-year CDR period, compared to 8.7 percent of borrowers who were in forbearance up to 18 months during this period, and 20.3 percent of borrowers who were not in forbearance during this period. Borrowers who default outside the 3-year CDR period will not negatively affect a school's CDR. In an online presentation, representatives from one consultant highlighted that forbearance can be a tool for reducing a school's CDR and stated that borrowers who postponed payments defaulted less often during the CDR period than other past-due borrowers based on a case study they conducted.

Figure 5: Example of How Long-term Forbearance Can Reduce the Potential for a Borrower to Default within the Cohort Default Rate Period



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

Note: For cohort default rate purposes, Education considers loans to be in default after 360 consecutive days past due.

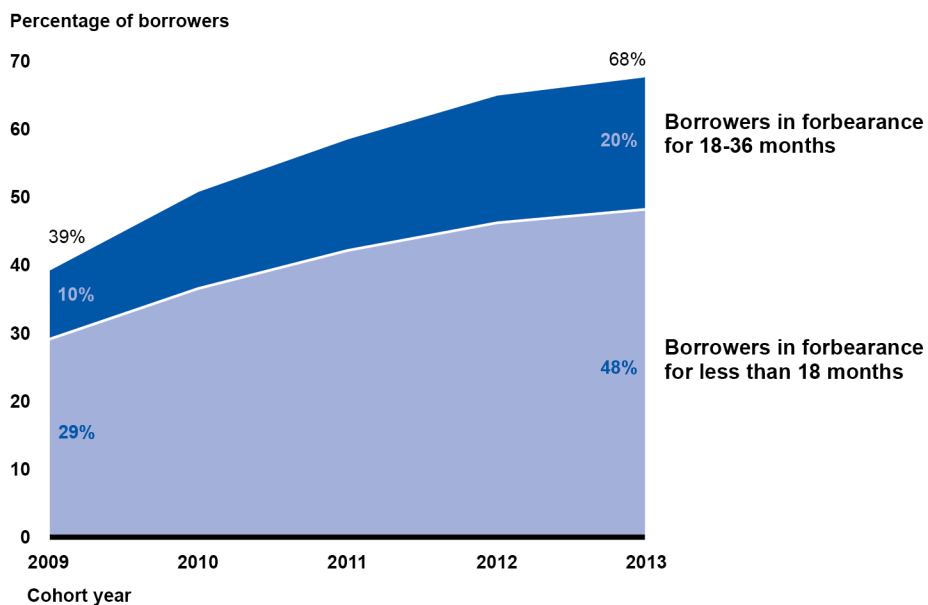
According to our analysis of Education’s data, the percentage of borrowers whose loans were in forbearance for 18 months or more during the 3-year CDR period increased each year during the 5 cohorts we reviewed, doubling from 10 percent in the 2009 CDR cohort to 20 percent in the 2013 CDR cohort.⁴⁵ During the same time period, the percentage of borrowers whose loans were in forbearance for any amount of time increased from 39 percent to 68 percent (see fig. 6).⁴⁶ Further, borrowers in forbearance for 18 months or more defaulted in the year after the 3-year CDR period more often than they did during the CDR period. Specifically, 9.4 percent of these borrowers in the 2013 CDR period defaulted in the year following the CDR period, while only 1.7 percent defaulted in the first 3 years of repayment, suggesting that long-term forbearance may have delayed, not prevented, default for these borrowers. Reducing the number of borrowers in long-term forbearance and directing them toward other repayment or postponement options could help reduce the number of borrowers that later default and save the government money. For example, Education estimates that it will not recover a certain percentage of defaulted Direct Loan dollars even if

⁴⁵ Unless otherwise stated, our analysis of Education’s data on student loans includes all 4,138 schools that had a CDR calculated for 2013. We excluded schools whose CDR was calculated using a different formula that Education uses for schools with fewer than 30 borrowers entering repayment in a particular cohort. In our analysis, the term “forbearance” includes all types of forbearance (general, mandatory, and administrative) unless otherwise stated.

⁴⁶ Of the total number of borrowers who were in forbearance for any amount of time during the 2013 cohort, 69 percent were in general forbearance, 2 percent were in mandatory forbearance, and about 30 percent were only in administrative forbearance. Borrowers may be in more than one type of forbearance during the 3-year CDR period. The data we requested from Education did not include mutually exclusive counts for each type of forbearance. According to Education officials, Education does not have information on the types of forbearance borrowers received from certain loans originated before July 2010 through the Federal Family Education Loan Program. As a result, the percentage of borrowers in each type of forbearance may be under-reported. Education officials said that a number of factors may have contributed to the increase in forbearance during each 3-year cohort period from 2009 to 2013. For example, more borrowers may have sought to postpone monthly payments due to financial hardships associated with the recession of 2007-2009. In addition, to ensure borrowers remain current on their loans, it is common for loan servicers to place borrowers in administrative forbearance while their application for an Income-Driven Repayment plan is being processed. Our analysis of Education data found that the percentage of borrowers in Income-Driven Repayment increased from 3 percent in the 2009 CDR cohort to 22 percent in the 2013 CDR cohort. Education officials also noted that borrowers were placed in administrative forbearance when Education began transferring loans from a single servicer to multiple servicers, beginning in 2009. However, administrative forbearances for these reasons should be for 60 days or less, according to Education officials, so they would not have contributed to the observed increase in borrowers in forbearance for 18 months or longer.

repayment resumes. Specifically, for Direct Loans issued in fiscal year 2018, Education estimates that it will not recover over 20 percent of defaulted loans. These unrecovered defaulted loan amounts total an estimated \$4 billion, according to our analysis of Education’s budget data.⁴⁷ In addition to cost savings to the government, borrowers who avoid default would not have to face severe consequences, such as damaged credit ratings that may make it difficult to obtain credit, employment, or housing.

Figure 6: Percentage of Borrowers in Forbearance for Varying Amounts of Time during the 3-Year Cohort Default Rate Period, 2009 to 2013 Cohorts



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

Note: This analysis was based on the population of 4,138 schools that had a cohort default rate (CDR) calculated for 2013. Schools whose CDR was calculated using a different formula that Education uses for schools with fewer than 30 borrowers entering repayment in a particular cohort were excluded from this analysis. Each type of forbearance is included in the analysis (general, mandatory, and administrative).

⁴⁷ The estimate accounts for collection costs and uses a net present value basis to account for the effect of time on the dollar value of missed payments due to default and subsequent default collections. The total estimate of defaulted dollars not recovered does not include Direct PLUS or Consolidation loans.

Comparing the Repayment Rate with the Cohort Default Rate (CDR)

The Department of Education's (Education) repayment rate measures the percentage of a school's borrowers who are not in default on their federal loans and have repaid at least \$1 of the principal loan amount during the first 3 years of repayment. According to Education, the repayment rate is less susceptible to manipulation than the CDR because schools may push borrowers to postpone payments, such as through forbearance, until the CDR measurement window expires to keep their CDRs low. However, a school's repayment rate would only improve if borrowers repay a portion of the principal on their loans during the first 3 years of repayment. According to Education officials, the monthly payments of some borrowers on Income-Driven Repayment plans may not be high enough to pay down any principal during the first 3 years of repayment.

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

In addition, the percentage of borrowers who made progress in paying down their loans during each CDR cohort—the repayment rate—decreased from 66 percent for the 2009 cohort to 46 percent for the 2013 cohort (see sidebar).⁴⁸

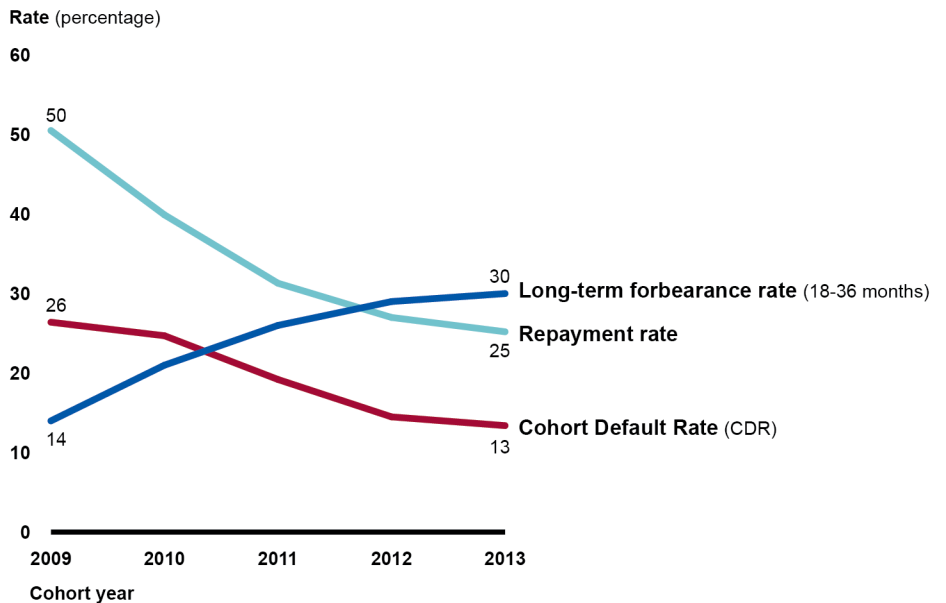
We analyzed these data for a subset of schools with the largest CDR decreases from the 2009 to 2013 cohorts and found that as these schools' CDRs improved, other borrower outcomes worsened (see app. II for more information about these schools).⁴⁹ Specifically, for this subset of schools, the percentage of borrowers in long-term forbearance doubled, and the percentage of borrowers who made progress in paying down their loans during the CDR period decreased by half, suggesting that these schools may be encouraging forbearance as a default management strategy (see fig. 7).⁵⁰

⁴⁸ The repayment rate measures the percentage of a school's borrowers who are not in default and have paid down at least \$1 of the principal loan amount 3 years after entering repayment. Education publishes this rate, along with the 1-, 5-, and 7-year repayment rates, in its College Scorecard data. Education officials noted that the increase in borrowers participating in Income-Driven Repayment plans beginning in 2009 may have contributed to the decrease in the 3-year repayment rate because some borrowers on these plans may have monthly payment requirements that do not cover accrued interest. These borrowers will not have paid down at least \$1 of the principal loan amount after 3 years in repayment.

⁴⁹ Specifically, we analyzed data for the 364 schools that had CDR decreases of 10 or more percentage points from the 2009 to 2013 cohorts. We excluded schools whose CDR was calculated using a different formula that Education uses for schools with fewer than 30 borrowers entering repayment in a particular cohort.

⁵⁰ The percentage of borrowers whose loans were in forbearance for any amount of time during each CDR period at these 364 schools increased from 47 percent (2009 cohort) to 80 percent (2013 cohort). Further, 11.3 percent of borrowers who attended these schools and were in forbearance for 18 months or more during the 2013 CDR period defaulted in the year following the CDR period, while only 1.4 percent defaulted in the first 3 years of repayment.

Figure 7: Selected Borrower Outcomes for Schools with Cohort Default Rate Decreases of 10 or More Percentage Points from the 2009 to 2013 Cohorts



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

Note: This analysis includes 364 schools that had the largest CDR decreases—10 percentage points or more—from the 2009 through 2013 cohorts. Schools whose CDR was calculated using a different formula that Education uses for schools with fewer than 30 borrowers entering repayment in a particular cohort were excluded from this analysis.

Education has acknowledged that when schools encourage borrowers to postpone loan repayment until the 3-year CDR period ends, it can have a distorting effect on the CDR. Borrowers who have postponed their payments through forbearance or deferment are considered to be “in repayment” for the purpose of calculating the CDR, even though they are not expected to make any payments on their loans while in these statuses. As a result, an increased use of forbearance, particularly long-term forbearance, could result in lower CDRs, and therefore fewer schools being sanctioned due to high CDRs.⁵¹ In July 1999, we reported that the CDR understates the actual number of borrowers who default. We suggested that Congress may wish to consider amending the Higher Education Act of 1965 to exclude borrowers with loans in deferment or

⁵¹ Further, because these borrowers are never placed in a subsequent cohort, they are never included in calculations of a school’s CDR, even if they default on their loans after the forbearance period is over.

forbearance at the end of the CDR period from schools' CDR calculation and include these borrowers in a future CDR cohort after they have resumed making payments on their loans.⁵² Education's Office of Inspector General made a recommendation to the agency to support similar amendments to the law in December 2003.⁵³

For this report, we examined the impact that removing borrowers in long-term forbearance from the CDR calculation would have on schools' reported CDRs.⁵⁴ For the 2013 cohort, 35 schools from our population had CDRs of 30 percent or higher.⁵⁵ When we excluded from our population borrowers who spent 18 months or more in forbearance and did not default within the 2013 CDR period, we found 265 additional schools that would potentially have had a CDR of 30 percent or higher

⁵² GAO, *Student Loans: Default Rates Need to Be Computed More Appropriately*, [GAO/HEHS-99-135](#) (Washington, D.C.: July 28, 1999). The report concluded that excluding such borrowers from the CDR is appropriate because a borrower with a loan in deferment or forbearance is generally not required to make loan payments and therefore has no exposure to default during the time the deferment or forbearance is in place. These legislative changes have not been made.

⁵³ Education's Office of Inspector General recommended that Education support amending the Higher Education Act of 1965, as amended, to exclude from the CDR calculation borrowers who are at low risk of default during the CDR cohort because their loans were in forbearance or deferment. The Office of Inspector General also recommended that these borrowers who are excluded from the CDR cohort be included in a future cohort. U.S. Department of Education Office of Inspector General, *Audit to Determine if Cohort Default Rates Provide Sufficient Information on Defaults in the Title IV Loan Programs*, ED-OIG/A03-C0017 (Philadelphia, PA.: Dec. 22, 2003).

⁵⁴ We did not assess the impact of deferments in this analysis, in part because the percentage of borrowers in deferment at any time during the CDR period remained stable—between 38 and 40 percent—for all schools for each cohort year from 2009 to 2013. Also, the percentage of borrowers in long-term deferment (which we defined as 18 months or more in deferment) decreased from 14 to 9 percent for all schools over this time period.

⁵⁵ Specifically, 30 schools had a 2013 CDR from 30-40 percent and 5 schools had a CDR above 40 percent, putting 35 total schools at risk for sanctions. Our analysis was based on the population of 4,138 schools that had a CDR calculated for 2013. We excluded schools whose CDR was calculated using a different formula that Education uses for schools with fewer than 30 borrowers entering repayment in a particular cohort.

(see app. II for more information about these schools).⁵⁶ Schools with CDRs at this level for 3 consecutive years may lose eligibility to offer their students Direct Loans and Pell Grants. Further, 21 of the 265 schools would potentially have had a CDR greater than 40 percent, making them potentially subject to immediately losing eligibility to offer Direct Loans. Of the 265 schools that would have potentially been subject to sanctions based on our alternative calculation, 261 received a combined \$2.7 billion in Direct Loans and Pell Grants in academic year 2016-2017.⁵⁷

The CDR is a key tool for holding schools accountable for borrower outcomes and protecting borrowers and the federal government from the costs associated with default. The substantial growth in the percentage of borrowers spending at least half of the CDR period in forbearance reduces the CDR's usefulness to hold schools accountable. This presents risks to the federal government and taxpayers, who are responsible for the costs associated with high rates of default, and to borrowers who may benefit from other repayment or postponement options. Since the way the CDR is calculated is specified in federal law, any changes to its calculation would require legislation to be enacted amending the law. Strengthening the usefulness of the CDR in holding schools accountable, such as by revising the CDR calculation or using other accountability measures to complement or replace the CDR, could help further protect both borrowers and the billions of dollars of federal student aid funds the government distributes each year.

⁵⁶ Excluding these borrowers from the CDR calculation had the effect of increasing the CDR at 4,057 of 4,138 schools. For the 2013 cohort, the percentage of borrowers in forbearance for 18 months or more who did not default during the CDR period at each school ranged from 0 percent to 65 percent. It is not possible to determine how many additional borrowers would have defaulted during the 3-year CDR period if they were not in a long-term forbearance. This analysis does not take into account whether school behavior contributed to rates of long-term forbearance or may change as a result of changes to the CDR calculation. For example, while forbearance would still be an option to help borrowers avoid default, removing borrowers in long-term forbearance from the CDR calculation may provide schools with greater incentive to encourage other options that may be more beneficial to borrowers, such as Income-Driven Repayment plans.

⁵⁷ Four of the 265 schools did not receive Direct Loans or Pell Grants in academic year 2016-2017. In addition, of the 21 schools that would potentially have had a CDR greater than 40 percent, making them potentially subject to immediately losing eligibility to offer Direct Loans, 19 received a combined \$106 million in Direct Loans in academic year 2016-2017.

Actions Needed to Improve Education's Oversight of Default Management Strategies and Public Reporting of CDR Sanctions

Requirements Needed to Oversee How Schools and their Consultants Communicate Loan Options to Borrowers in Repayment

Education's ability to oversee the strategies that schools and their consultants use to manage CDRs is limited because there are no requirements governing the interactions that schools and their consultants have with borrowers once they leave school. Education requires that schools provide certain information to borrowers about their student loans when they begin and finish school but does not oversee schools' or their consultants' communications with borrowers after they leave school. According to Education, the Higher Education Act does not contain explicit provisions that would allow it to impose requirements governing communications that schools and their consultants may have with borrowers who have left school.

As noted earlier, we found that some default management consultants, in seeking to help schools lower their CDRs, provided borrowers inaccurate or incomplete information or offered gift cards to encourage forbearance over other repayment or postponement options that may be more beneficial to the borrower. According to Education officials, borrowers are protected from such practices because loan servicers are required to inform borrowers of all available repayment options upon processing a forbearance. Education officials also said that performance-based contracts provide loan servicers an incentive to keep borrowers in repayment.⁵⁸ However, a Consumer Financial Protection Bureau report

⁵⁸ Education began awarding performance-based contracts to loan servicers in 2009. Under performance-based contracts, the contracting agency specifies the outcome or result it desires and leaves it to the contractor to decide how best to achieve the desired outcome. Loan servicers receive monthly payments from Education for each borrower they service, with the amount per borrower based on the borrower's loan status. For example, loan servicers receive \$2.85 per month for each borrower in repayment, \$1.68 for each borrower in deferment, and \$1.05 for each borrower in forbearance.

found that borrowers may not be informed about the availability of other repayment plans and instead may be encouraged by their loan servicers to postpone payments through forbearance, which may not be in borrowers' best interests.⁵⁹ Further, some consultant practices we identified, such as instructing borrowers to return the forbearance application to the consultant and remaining on three-way calls with the loan servicer and the borrower, may undermine the role of the loan servicer. Education officials also said that borrowers should be aware of their repayment options because schools are required to inform borrowers of these options through exit counseling when they leave school. However, in 2015 we found gaps in borrowers' awareness of repayment options.⁶⁰ Education's Office of Federal Student Aid has a strategic goal to help protect borrowers and families from unfair, deceptive, or fraudulent practices in the student loan marketplace.⁶¹ Without clear requirements regarding the information that schools and their consultants provide to borrowers after leaving school, Education cannot effectively oversee schools' default management strategies. Further, without such requirements, Education cannot ensure that schools and consultants are providing borrowers with the information they need to make informed decisions to manage their loan costs and avoid future default.

⁵⁹ The report recommended that policymakers and stakeholders, including Education, work to improve multiple aspects of loan servicing, including ensuring that the information student loan servicers provide borrowers is accurate and empowers borrowers to take action on their loans. Consumer Financial Protection Bureau, *Student Loan Servicing: Analysis of Public Input and Recommendations for Reform* (Washington, D.C.: September 2015).

⁶⁰ For example, we found that some borrowers who could benefit from Income-Driven Repayment plans may not be aware of them. We recommended that Education take steps to consistently and regularly notify all borrowers who have entered repayment of these options. Education generally agreed with our recommendation and has taken steps to provide more information on Income-Driven Repayment plans to certain groups of borrowers, including those who were in school or in the 6-month grace period after leaving school, expressed interest in these plans during exit counseling, were less than 227 days delinquent, or had Federal Family Education Loans. GAO acknowledged that these are positive steps and will close this recommendation when the Department demonstrates that it has taken action to ensure that *all* borrowers in repayment are consistently informed of the availability of these repayment plans. [GAO-15-663](#).

⁶¹ U.S. Department of Education, Federal Student Aid, *Federal Student Aid: Strategic Plan, Fiscal Years 2015-2019* (Washington, D.C.: November 2016).

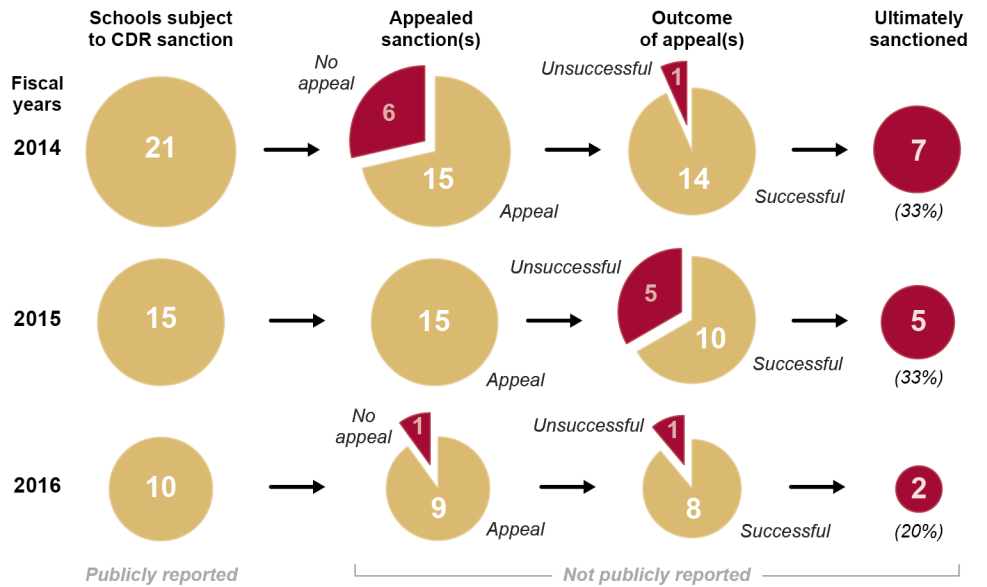
Education's Public Reporting of Cohort Default Rate Sanctions Lacks Transparency

The limited information Education reports annually to the public about schools that face sanctions for high CDRs overstates the extent to which schools are held accountable for their default rates. Specifically, Education does not report the number of schools that successfully appealed CDR sanctions or the number of schools ultimately sanctioned.⁶² For example, with the release of the 2013 CDRs in 2016, Education publicly reported that 10 schools were subject to sanctions, but did not publicly report that 9 schools appealed their sanctions and 8 were successful in their appeals and were thereby not sanctioned (see fig. 8).⁶³

⁶² If a school is notified that it is subject to sanction, the school may submit an appeal to attempt to avoid that sanction. There are six different types of appeals and one adjustment available to schools that are subject to sanction. According to Education data, the three types of appeals that were successful from 2014 to 2016 were the Economically Disadvantaged Appeal, Loan Servicing Appeal, and Uncorrected Data Adjustment. The Economically Disadvantaged Appeal is granted to schools with a high percentage of low-income students and is based on low-income student and placement rates (non-degree-granting schools) or on low-income student and completion rates (degree-granting schools). The Loan Servicing Appeal removes loans that were improperly serviced from the CDR calculation. The Uncorrected Data Adjustment allows schools subject to sanction to contest that their official CDR calculation did not reflect revisions to the school's draft CDR agreed to by Education.

⁶³ Education releases each school's CDR and a list of schools subject to CDR sanctions in the fiscal year following the 3-year CDR period. For example, the 2013 CDR was released in September 2016.

Figure 8: Schools Subject to Education Cohort Default Rate (CDR) Sanction and Appeals Outcomes, Fiscal Years 2014–2016



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

Note: Fiscal year 2014 was the first year schools were sanctioned based on a 3-year CDR calculation, and fiscal year 2016 was the most recent year for which sanction and appeals data were available at the time of GAO’s analysis. Schools may be subject to sanction if their CDR is above 40 percent for one year or if their CDRs are at or above 30 percent for 3 consecutive years. Schools that exceeded both thresholds in the same year were only counted once. There are six types of appeals and one adjustment available to schools subject to sanction; we refer to these collectively in the figure as appeals.

Office of Management and Budget guidelines call for federal agencies to ensure and maximize the usefulness of information they disseminate to the public.⁶⁴ Federal internal control standards call for effective communication with external stakeholders.⁶⁵ The number of schools subject to sanction has declined over time—from a high of 1,028 schools

⁶⁴ Office of Management and Budget, *Guidelines for Ensuring and Maximizing the Quality, Objectivity, Utility, and Integrity of Information Disseminated by Federal Agencies* (Washington, D.C.: Sept. 24, 2001).

⁶⁵ [GAO-14-704G](#).

in fiscal year 1994 to 10 schools in fiscal year 2017 (see app. III).⁶⁶ In addition, unpublished sanction data reveal that a small fraction of borrowers who defaulted on student loans attended schools that have been sanctioned. For example, two schools were ultimately sanctioned in 2016 and accounted for 67 of the nearly 590,000 borrowers whose defaulted loans were included in schools' 2013 CDRs.⁶⁷ By reporting only the number of schools subject to sanction and not those actually sanctioned, Education's data make it difficult for Congress and the public to assess the CDR's usefulness in holding schools accountable.

Conclusions

Preventing student loan defaults is an important goal, given the serious financial risks default poses to borrowers, taxpayers, and the federal government. The CDR, which is specified in federal law, is intended to hold schools accountable when significant numbers of their borrowers default on their student loans during the first 3 years of repayment. However, the metric in its current form creates incentives for schools that may result in unintended consequences for some borrowers. Schools have an interest in preventing their students from defaulting during the CDR period to ensure that they can continue to participate in federal student aid programs, and some schools contract with private consultants to work with borrowers who have fallen behind on their loan payments. Although some of these consultants have recently changed their communications to borrowers, others continue to provide inaccurate or incomplete information to encourage past-due borrowers to choose forbearance over other repayment options. While postponing payments through forbearance may help struggling borrowers avoid default in the near term, it increases borrowers' ultimate repayment costs and does not necessarily put borrowers on a path to repaying their loans. Moreover, including borrowers who spend 18 months or more in forbearance in the CDR calculation reduces the CDR's ability to hold schools accountable for high default rates since long periods of forbearance appear to delay—

⁶⁶ Education released information on the number of schools (10) subject to sanction for 2017 in September 2017, but the appeals process had not yet been completed at the time of our analysis. Education officials gave several explanations for this decline, including that many of the schools subject to sanction in earlier years have lost their eligibility to participate in federal student aid programs, and that both the Department and schools have worked together to reduce schools' CDRs.

⁶⁷ Education releases each school's CDR and a list of schools subject to CDR sanctions in the fiscal year following the 3-year CDR period. For example, information on schools subject to sanction based on their 2013 CDRs was released in September 2016. This was the most recent appeal and sanction information available at the time of our analysis.

not prevent—default for some borrowers. Absent a statutory change, schools and their consultants seeking to keep CDRs below allowable thresholds will continue to have an incentive to promote forbearance over other solutions that could be more beneficial to borrowers and less costly to the federal government and its taxpayers.

Education plays an important role in overseeing schools and their default management consultants to ensure that they are held accountable and student loan borrowers are protected. However, because Education asserts that it lacks explicit statutory authority to establish requirements regarding the information that schools and consultants provide to borrowers after they leave school, Education does not hold them accountable for providing accurate and complete information about repayment and postponement options. In addition, public information on CDR sanctions is important for assessing the usefulness of the CDR to hold schools accountable. Yet, Education’s practice of reporting the number of schools potentially subject to sanction without reporting the number of schools ultimately sanctioned following the appeals process limits transparency about the CDR’s usefulness for Congress and the public.

Matters for Congressional Consideration

We are making the following two matters for congressional consideration:

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

Congress should consider requiring that schools and default management consultants that choose to contact borrowers about their federal student loan repayment and postponement options after they leave school present them with accurate and complete information. (Matter 2)

Recommendation for Executive Action

The Chief Operating Officer of the Office of Federal Student Aid should increase the transparency of the data Education publicly reports on school sanctions by adding information on the number of schools that are annually sanctioned and the frequency and success rate of appeals. (Recommendation 1)

Agency Comments and Our Evaluation

We provided a draft of this product to the Department of Education for review and comment. Education's comments are reproduced in appendix IV. We also provided relevant report sections to the Consumer Financial Protection Bureau and the nine default management consultants for technical comment. The Consumer Financial Protection Bureau provided technical comments, which we incorporated as appropriate.

Education agreed with our recommendation to increase transparency of school sanction data. In its response, Education stated that it makes a significant amount of CDR data publicly available on its website. For example, Education posts CDRs and underlying data for each school for which the rates are calculated and lists schools subject to sanctions as a result of their CDRs. Education also stated that beginning with the release of fiscal year 2015 CDRs, it would provide additional information on its website indicating whether schools subject to sanctions have submitted appeals and the disposition of such appeals. As we recommended in our draft report, Education should also publicly report the number of schools ultimately sanctioned each year.

Our draft report included a recommendation for Education to seek legislation to strengthen schools' accountability for student loan defaults. Education disagreed with this recommendation, asserting that from a separation of powers perspective, it has a responsibility to implement, and not draft, statutes. Education stated that if GAO believes such legislation is needed, it would be best addressed as a matter to Congress. We agree that, as an executive agency, Education is responsible for implementing laws as enacted. However, it is important to note that the President has the "undisputed authority" to recommend legislation to the Congress⁶⁸ and the Office of Management and Budget within the Executive Office of the President has outlined procedures for

⁶⁸ Ass'n of Am. Physicians & Surgeons v. Clinton, 997 F.2d 898, 908 (D.C. Cir. 1993) (discussing Article II, section 3 of the U.S. Constitution which states that the President "shall from time to time [. . .] recommend to [the Congress's] consideration such measures as he shall judge necessary and expedient" and describing the Recommendation Clause as the source from which all executive branch authority to recommend legislation derives). As an example of this authority from an Education-related statute, see 20 U.S.C. § 3486, which requires the Secretary to make annual reports to the President for transmission to Congress, covering the activities of the Department, and requires these reports to include, among other things, recommendations for proposed legislation where necessary.

executive branch agencies to submit proposed legislation.⁶⁹ Indeed, in making this recommendation, we intended that Education seek legislation through any of the practices used by executive branch agencies in communicating with Congress. In a recent example, both the President's Budget Request and Education's Congressional Budget Justification for Fiscal Year 2019 seek a change in the statutory allocation formula for the Federal Work-Study program to focus funds on institutions enrolling high numbers of Pell Grant recipients.⁷⁰ Nevertheless, in light of Education's disagreement with our draft recommendation, and the importance of strengthening schools' accountability for student loan defaults, we have converted the recommendation into a Matter for Congressional Consideration.

Our draft report also included a recommendation for Education to require that schools and default management consultants that contact borrowers about repayment and postponement options after they leave school present accurate and complete information. Education agreed that institutions should provide accurate and complete information about all repayment options. It also stated that institutions should allow the borrower's stated preference for any given repayment option to guide the ultimate direction of the conversation, and that the information provided should be free from financial incentive. However, Education asserted that it "cannot impose requirements on schools and their consultants without further authority." Education clarified in a follow-up communication that the Higher Education Act does not contain "explicit provisions" under which it could require schools (and their consultants) to include specific content in the information that they choose to provide to borrowers after the borrowers leave school, but did not address whether there was any other authority under which it could take action in this area. Instead, Education noted that it could provide information to schools and their consultants on best practices in this area. We continue to believe that schools and their consultants should be required to ensure that any information they present to borrowers about repayment and postponement options after they leave school is accurate and complete. As we stated in our draft report, without clear requirements in this area,

⁶⁹ Office of Management and Budget, OMB Circular No. A-19: Legislative Coordination and Clearance (Washington, D.C., revised Sept. 20, 1979).

⁷⁰ Office of Management and Budget, Efficient, Effective, Accountable: An American Budget; Appendix, Budget of the U.S. Government, Fiscal Year 2019 (Washington, D.C.); Department of Education, Student Financial Assistance: Fiscal Year 2019 Budget Request (Washington, D.C.).

Education cannot ensure that schools and consultants provide borrowers with the information they need to make informed decisions to manage their loan costs and avoid future default. In light of this, and Education's response to our draft recommendation, we have converted our recommendation into a Matter for Congressional Consideration.

In its comments, Education inaccurately asserted that our findings should be viewed in light of a limited scope. As stated in the draft report, we analyzed trends in forbearance, repayment, and default using national data from Education for the five most recent CDR cohorts for a population of over 4,000 schools. To determine how schools work with borrowers to manage their CDRs, we reviewed the practices of a nongeneralizable sample of nine default management consultants that served over 1,300 schools. These schools accounted for over 1.5 million borrowers in the 2013 CDR cohort. The five consultants that provided inaccurate or incomplete information about forbearance or offered gift cards served about 800 schools, which accounted for over 875,000 borrowers in the 2013 CDR cohort. For each of the consultants, as stated in our draft report, we reviewed documentation including training materials, internal policies and procedures, and examples of correspondence they send to borrowers. Finally, Education inaccurately asserted that we based our findings on a small sample of interviews with 11 borrowers and officials from 3 schools and 4 consultants. We conducted these interviews to better understand borrowers' loan experiences and the strategies that schools and their consultants use to manage the CDR, and the illustrative interview examples we include in our report do not form the basis of any of our findings or recommendations.

In addition, Education commented that the report did not consider the extent to which borrowers enter Income-Driven Repayment plans during the 3-year CDR period or the substantial growth in borrowers participating in these plans over the past several years. Education suggested that such data would be important to consider in determining whether there has been an overreliance on forbearance in the past, and if so, whether any problems in this area are being remedied by the availability of Income-Driven Repayment plans. We have incorporated additional information regarding the increase in borrowers participating in Income-Driven Repayment plans in response. As Education noted in its comments, our draft report acknowledged that increased participation in these plans may have been a factor in the observed increase in overall rates of forbearance since it is common for loan servicers to place borrowers in administrative forbearance while processing applications for Income-Driven Repayment plans. However, as explained in our draft report, since

administrative forbearance for this purpose should be for 60 days or less it would not explain the twofold increase in the percentage of borrowers in forbearance for 18 months or longer from CDR cohort years 2009 to 2013.

Education also stated that while our report included an example of the additional interest cost incurred by a borrower using forbearance, it did not discuss the potential additional interest costs associated with other repayment options, such as Income-Driven Repayment plans. Education noted that these options could be more costly than forbearance in some instances and all options have consequences for borrowers. We acknowledged in our draft report that interest continues to accrue on loans in Income-Driven Repayment and that the monthly payments of some borrowers on these plans may not be high enough to pay down any principal during the first 3 years of repayment. However, as stated in our draft report, Income-Driven Repayment plans, unlike forbearance, offer borrowers the potential for loan forgiveness after 20 or 25 years of repayment. We have incorporated additional details about the potential costs of these and other repayment plans based on Education's comments. The potential consequences that Education highlighted in its comments further illustrate the importance of ensuring that borrowers receive accurate and complete information to help them make informed decisions to manage their loan costs and avoid default.

In response to our findings regarding communication practices of some default management consultants, Education stated that the draft report did not acknowledge that the forbearance application that selected consultants send to borrowers provides an opportunity for borrowers to learn about other repayment options and the potential costs of forbearance. We have incorporated additional information regarding the information included on the application. Although the form mentions deferment and Income-Driven Repayment, it does not describe these options; instead, it directs borrowers to Education's website for more information. Therefore, we maintain that borrowers who only receive a forbearance application may inaccurately assume that forbearance is the only or preferred option.

Further, Education commented that the draft report did not examine what effect, if any, consultants may have had in encouraging borrowers to seek consecutive forbearances since borrowers can remain in forbearance for no longer than 12 months before they have to reapply. Education also suggested that comparing the use of forbearance at schools that hired consultants that encouraged borrowers to postpone payments with those

that did not would have provided a better understanding of the potential impact of such practices. While these topics were beyond the scope of our objectives for this report, Education may wish to explore them in support of its goals to protect borrowers and mitigate risks in the federal student aid programs.

We are sending copies of this report to the appropriate congressional committees, the Secretary of the Department of Education, the Director of the Consumer Financial Protection Bureau, and other interested parties. In addition, the report will be available at no charge on GAO's website at <http://www.gao.gov>.

If you or your staff have any questions about this report, please contact me at (617) 788-0534 or emreyarrasm@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made key contributions to this report are listed in appendix V.

Melissa Emrey-Arras

Melissa Emrey-Arras, Director
Education, Workforce, and Income Security Issues

Appendix I: Objectives, Scope, and Methodology

This appendix discusses in detail our methodology for addressing (1) how schools work with borrowers to manage schools' cohort default rates (CDR), and how these strategies affect borrowers and schools' accountability for defaults; and (2) the extent to which the Department of Education (Education) oversees the strategies schools and their default management consultants use to manage schools' CDRs and informs the public about its efforts to hold schools accountable.

We conducted this performance audit from May 2016 to April 2018, in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Default Management Consultants – Interviews and Document Requests

To determine how schools work with borrowers to manage their cohort default rates, we examined the practices of companies that schools contract with to help them lower their CDRs. Specifically, we selected a nongeneralizable sample of 9 of the 48 default management consultants on file with Education as of December 2016. To select the 9 consultants, we obtained lists of client schools from Education and reviewed websites for each of the 48 consultants to determine the services each company offered. Some companies offered an array of services to schools, while others focused exclusively on default management. We selected our nongeneralizable sample of 9 consultants by prioritizing those with large numbers of client schools, those with a specific focus on default management, or those with unique default management practices based on our review of their websites. These 9 companies served over 1,300 schools.¹ These schools accounted for over 1.5 million borrowers in the 2013 CDR cohort.

We reviewed documentation from the 9 consultants on the strategies they use to reduce borrower defaults during the CDR period; their organizational structure; products and services offered; current client schools; internal training materials; contracts and agreements with

¹ For 8 of the consultants, we counted schools as clients if they hired the consultant to contact federal student loan borrowers on their behalf in 2017. The count for one consultant was based on the number of schools that it contracted with for this service in 2016 since it reported that it stopped contacting borrowers on behalf of schools in 2016.

schools; methods of compensation for employees responsible for outreach to student loan borrowers; internal policies and procedures; and examples of correspondence (e.g., emails, letters, and repayment applications) with borrowers. Based on the information received from these consultants, we cannot determine how many borrowers were contacted or received correspondence from these companies. However, the consultants we spoke to generally indicated that the materials they provided to us were used for all or most of their school clients.

To learn more about the strategies schools and default management consultants use to help schools manage their CDRs, we conducted interviews with managers at 4 of the 9 consultants. We also interviewed employees responsible for working with student loan borrowers to discuss the procedures they use to contact or counsel borrowers on loan repayment options. We selected these 4 consultants by prioritizing those that provided default management services to large numbers of client schools, or had unique default management practices based on website reviews.

Schools and Borrowers – Interviews and Document Requests

To determine how schools work with borrowers to manage schools' CDRs we selected a nongeneralizable sample of 12 schools for review based on data from Education that suggested that they had successfully lowered their CDRs from the 2009 through 2013 cohorts through forbearance. This sample informed our selection of borrowers. We emailed borrowers who attended these 12 schools and requested interviews with them, and selected 3 of the 12 schools for interviews with school officials and document requests.

To select the 12 schools, we analyzed CDRs for the 2009-2013 cohorts from Education's Cohort Default Rate Database; 3-year forbearance rates for fiscal years 2009-2012 from Education's Annual Risk Assessment data; and 3-year repayment rates for fiscal years 2009-2014 from Education's College Scorecard data.² We selected the 12 schools from the population that had a CDR calculated for 2013. We excluded schools whose 2013 CDR was calculated using a different formula that Education uses for schools with fewer than 30 borrowers entering repayment in a

² The Cohort Default Rate Database, Annual Risk Assessment data, and College Scorecard all contain nationally-comparable data on higher education institutions.

particular cohort.³ To be considered for selection, schools had to have had CDRs of 25 percent or above for cohort years 2009-2013 and also be in the following: 1) top 20 percent of year-to-year decreases in CDR; 2) top 20 percent of year-to-year increases in 3-year forbearance rates; or 3) top 20 percent of 3-year forbearances that resulted in default after the 3-year CDR period ended. This analysis resulted in a list of 312 schools, which we randomized within strata based on combinations of institutional control (public, nonprofit, and for-profit), maximum length of degree programs offered (less than 4-year or 4-year and above), and school size (fewer than 1,000 borrowers entering repayment in a given fiscal year and 1,000 or more borrowers entering repayment in a given fiscal year).⁴ We removed schools that had fewer than 1,000 borrowers entering repayment in a given fiscal year to mitigate the wide variations in forbearance rates and CDRs that may occur at smaller schools. Finally, we judgmentally selected a total of 12 schools from across the remaining strata, choosing the schools from each stratum in the randomized order. We conducted interviews with officials at 3 of these schools (public, nonprofit, and for-profit) and reviewed documentation on the strategies they use to reduce borrower defaults during the CDR period.

To examine how default management strategies may affect borrowers, we obtained record-level data from Education's National Student Loan Data System (NSLDS) related to the 12 schools we focused on in our review, including data on all loans that entered repayment from fiscal years 2011-2014 and contact information for the borrowers that took out these loans.⁵ We weighted the sample toward borrowers whose loans were in deferment, forbearance, or were consolidated during the CDR period or defaulted after the CDR period.⁶ We then randomly selected about 6,500 of these borrowers and emailed them a request to discuss their student loan repayment experience with us. We received replies

³ If a school has fewer than 30 borrowers entering repayment in a fiscal year, Education combines data from the 3 most recent cohorts to calculate an average CDR.

⁴ Randomizing the selection of schools reduced the risk of a biased selection from the subpopulation that met our criteria. However, the randomization does not imply that the sample will produce estimates that are generalizable to any specific population, because the design did not use probability sampling methods.

⁵ NSLDS is Education's central database for federal student aid information.

⁶ Although Consolidation Loans are not directly included in the cohort default rate calculation, a defaulted consolidation loan may cause a borrower to be included in the numerator of the cohort default rate calculation. This occurs if the consolidation loan defaults within the cohort default period that is applicable to the underlying loan(s).

from 49 borrowers and interviewed 11 of them that we thought may have been contacted by their school or a default management consultant. We generally selected borrowers for interviews in the order they replied to us. We also prioritized borrowers whose email responses included student loan experiences that were relevant to our objectives, such as receiving communication from their school about student loan repayment and postponement options. We were not able to interview borrowers who did not provide phone numbers or who provided phone numbers but did not respond to our calls.

Data Analysis

To determine how schools' default management strategies affect borrowers and the CDR, we analyzed school-level data from Education on borrowers with loans that were included in schools' official CDR calculations for the 2009 through 2013 cohorts.⁷ We selected the 2009 cohort because it was the first cohort held accountable for the 3-year CDR.⁸ The 2013 cohort was the most recent CDR available at the time of our analysis. We identified the year borrowers entered repayment using the same logic that Education does for calculating the CDR.⁹ A borrower with multiple loans from the same school whose loans enter repayment during the same cohort fiscal year was included in the formula only once for that cohort fiscal year.¹⁰ We excluded schools whose CDR was

⁷ Specifically, we analyzed data from a custom NSLDS dataset provided by Education, Education's public Cohort Default Rate Database, 3-year repayment rates from the College Scorecard, and Direct Loan and Pell Grant disbursements from the public Federal Student Aid Data Center, matching the datasets together using schools' unique 6-digit ID numbers.

⁸ Prior cohorts were subject to a 2-year CDR. As required by the Higher Education Opportunity Act, starting with fiscal year 2009, schools are subject to a 3-year CDR.

⁹ Education's CDR calculation does not include PLUS Loans and loans made under the Federal Perkins Loan Program, which has its own default rate calculations and consequences. Direct Loans included in the CDR calculation include Subsidized and Unsubsidized Stafford Loans. Subsidized and Unsubsidized Stafford Loans disbursed under the Federal Family Education Loan Program prior to July 2010 are also included in the CDR calculation for schools.

¹⁰ For CDR calculation purposes, if the borrower rehabilitates a defaulted loan before the end of the 3-year CDR period, the borrower is no longer considered to be in default. Rehabilitation is a method by which a borrower may resolve the status of defaulted loans by making 9 payments, each within 20 days of the due date, during a period of 10 consecutive months. Few loans are rehabilitated within the 3-year CDR period because it takes a minimum of 22 months to default and then rehabilitate a loan (12 months to default and another 10 months of payments).

calculated using a different formula that Education uses for schools with fewer than 30 borrowers entering repayment in a particular cohort.

For the population of 4,138 schools that had a CDR calculated for 2013¹¹ and a subset of 364 schools that had CDR decreases of 10 or more percentage points from the 2009 to 2013 cohorts, we analyzed

- cohort default rates (cohorts 2009-2013);
- the percentage of borrowers who were in forbearance for any length of time during their first 3 years in repayment (cohorts 2009-2013);¹²
- the percentage of borrowers who were in forbearance for 18 or more months during their first 3 years in repayment (cohorts 2009-2013);
- the percentage of borrowers who paid down at least \$1 of the principal loan amount during the first 3 years of repayment (cohorts 2009-2013); and
- the percentage of borrowers who were in forbearance for varying lengths of time during their first 3 years in repayment and then defaulted in the year following the CDR period (2013 cohort).

We also calculated an alternative CDR for each of these 4,138 schools, in which we excluded borrowers who spent 18 or more months in forbearance during the 2013 cohort and did not default during the CDR period from their school's CDR calculation.¹³ We analyzed how many schools would have potentially exceeded the 30 percent and 40 percent CDR thresholds for the 2013 cohort and calculated the total amount of Direct Loans and Pell Grants that these schools received in academic year 2016-2017. We did not estimate the number of schools that could become ineligible to participate in federal loan programs under this alternative methodology because such schools would be entitled to an

¹¹ While about 6,000 schools participate in federal student aid programs, they can be grouped together for purposes of calculating the CDR; for instance, a network of community colleges or for-profit schools owned by the same company.

¹² Each type of forbearance is included in these analyses: general, mandatory, and administrative. Education tracks in NSLDS the type of forbearance for Direct Loans and Federal Family Education loans owned by the Department, but does not track forbearance type for commercially-owned Federal Family Education Loans, according to agency officials. As a result, when we report percentages by forbearance type, each may be under-reported.

¹³ Schools' CDRs were calculated from a custom NSLDS dataset provided by Education.

appeal and sanctionable thresholds may change with the advent of new methodologies of calculating the CDR. Further, schools may change their default management strategies in response to an alternative CDR. In addition, we assessed the CDR against government standards for internal control for identifying and responding to risks and goals and objectives in the Office of Federal Student Aid's Fiscal Year 2015-2019 Strategic Plan.

Additionally, we analyzed data from Education's Integrated Postsecondary Education Data System on sector and program length for these 4,138 schools, as well as for certain subsets of these schools (for more information, see app. II).

To assess the reliability of the data elements we analyzed for our study, we (1) performed electronic testing of required data elements; (2) reviewed existing information about the data and the systems that produced them; and (3) interviewed agency officials knowledgeable about the data. We determined that the data were sufficiently reliable for the purposes of this report.

Review of Education Documents and Relevant Federal Laws and Regulations

To determine the extent to which Education oversees the strategies schools and their default management consultants use to manage schools' CDRs and informs the public about its efforts to hold schools accountable, we reviewed relevant federal laws, regulations, guidance, and internal documentation from Education on how it oversees schools and default management consultants practices as they relate to the CDR and how it implements and reports CDR sanctions. To better understand how CDRs are used in Education's oversight of schools, we reviewed relevant regulations and interviewed Education officials responsible for administering program review, recertification for eligibility for federal student aid, and oversight of the CDR including default prevention.¹⁴ We assessed Education's oversight activities against goals and objectives in the Office of Federal Student Aid's Fiscal Year 2015-2019 Strategic Plan, government standards for internal control for communicating with stakeholders, and Office of Management and Budget guidelines for disseminating public information.

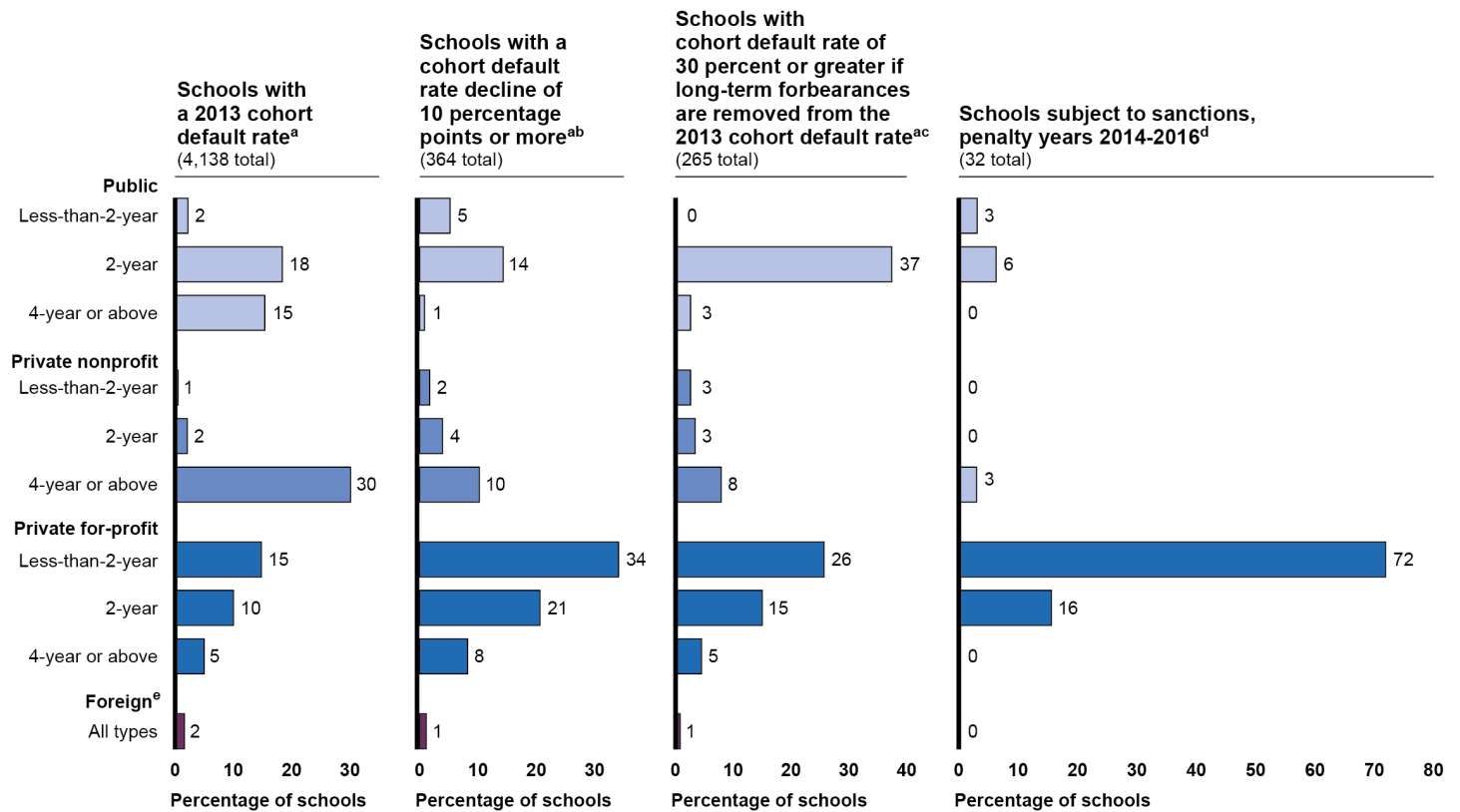
¹⁴ Education conducts program reviews to confirm that a school complies with Department requirements for institutional eligibility, financial responsibility, and administrative capability. Through its certification process, Education reviews schools to ensure that they are administratively and financially capable of providing the education they promise and of administering these grants and loans in compliance with Title IV program requirements.

Interviews with Experts and Consumer Advocates

To help us understand how the default management strategies used by schools and default management consultants affect borrowers and reported CDRs, we interviewed individuals with expertise on federal student loans. Specifically, we interviewed experts from federal agencies including the Consumer Financial Protection Bureau and Education's Office of Inspector General. We also interviewed experts from the Association of Community College Trustees, the Career Education Colleges and Universities, the Center for American Progress, The Institute for College Access & Success, Harvard's Project on Predatory Student Lending, the Illinois Attorney General Office, and Young Invincibles.

Appendix II: Sector and Program Length of Schools with Selected Characteristics

Figure 9: Sector and Program Length of Schools with Selected Characteristics



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

^aSchools whose cohort default rates (CDR) were calculated using a different formula that Education uses for schools with fewer than 30 borrowers entering repayment in a particular cohort were excluded from this analysis.

^bSchools were included in this analysis if their CDR decreased by 10 percentage points or more from the 2009 to 2013 CDR cohorts.

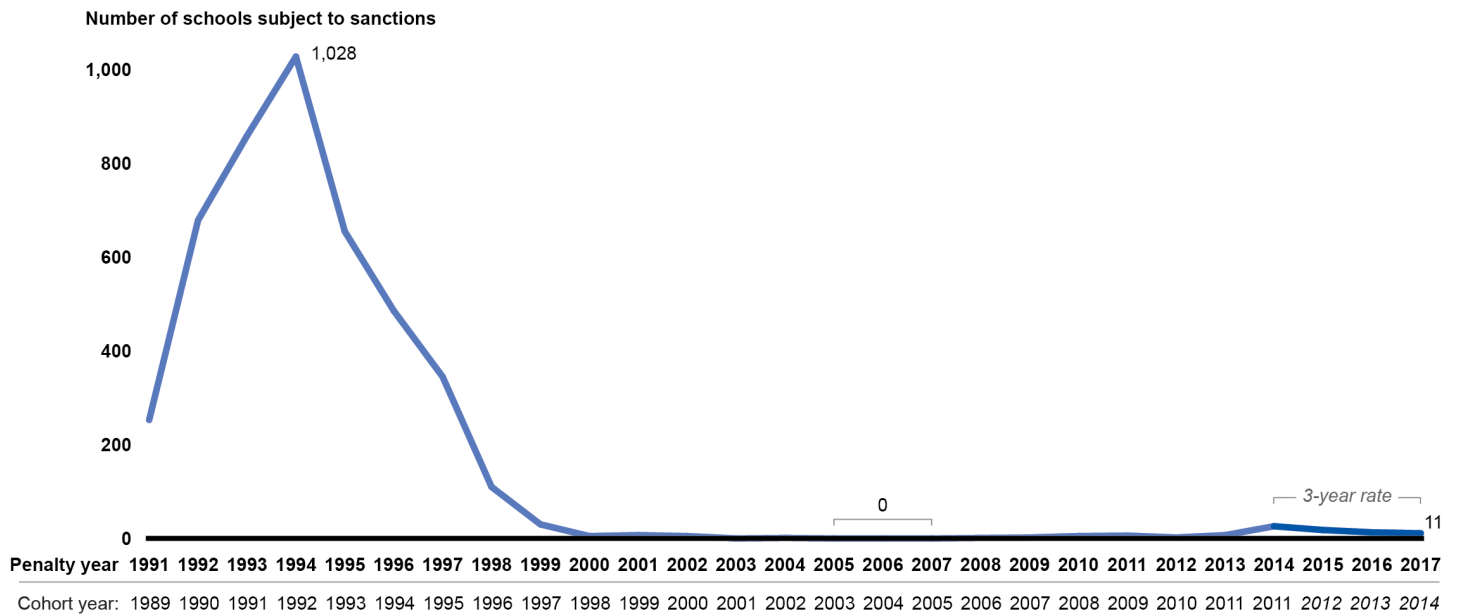
^cGAO defines long-term forbearance as 18 months or more during the 3-year CDR period. Schools with CDRs of 30 percent or above for 3 consecutive years are at risk for CDR sanctions.

^dSchools are subject to CDR sanctions if their CDR is 30 percent or above for 3 consecutive years or above 40 percent in a single year. Twelve schools were subject to sanctions multiple times in penalty years 2014-2016. However, we only counted these schools once for this analysis.

^eForeign schools include schools that are eligible to participate in the Direct Loan program and are located outside the United States.

Appendix III: Number of Schools Subject to Department of Education Cohort Default Rate Sanctions, 1991-2017

Figure 10: Number of Schools Subject to Department of Education Cohort Default Rate Sanctions, 1991-2017



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

Note: Schools are generally subject to sanctions if their CDRs are above certain thresholds. The CDR calculation and thresholds have changed over time. Education switched from a 2-year CDR calculation to a 3-year calculation as required by the Higher Education Opportunity Act. 2014 was the first year schools were subject to sanctions as a result of their 3-year CDR. Schools that are subject to sanctions may avoid sanctions if they successfully appeal. As a result, the same school may be subject to sanctions in multiple years. Schools may be double-counted if their CDRs exceeded more than one threshold in the same penalty year.

Appendix IV: Comments from the U.S. Department of Education



March 12, 2018

Ms. Melissa Emrey-Arras
Director, Education, Workforce, and Income Security Issues
United States Government Accountability Office
Washington, D.C. 20548

Dear Ms. Emrey-Arras:

Thank you for providing the U.S. Department of Education (“Department”) with the opportunity to respond to the draft Government Accountability Office (GAO) report, “FEDERAL STUDENT LOANS: Actions Needed to Improve Oversight of Schools’ Default Rates” (GAO-18-163; Job Code 100859).

Last year, the Department’s Federal Student Aid (FSA) office provided more than \$120 billion in federal grants, loans, and work-study funds to approximately 13 million students at nearly 6,000 participating institutions of higher education. These funds make higher education accessible and affordable for students and their families. Improving customer service and responsibly managing the federal investment in federal student aid programs are very important to our mission.

In conducting its study, GAO reviewed documents from nine of 48 consultants it identified as providing services to schools including default prevention and spoke to managers at four of these consultants; spoke to officials at three institutions of higher education; and, interviewed only 11 borrowers out of the 49 who replied to a GAO e-mail sent to 6,500 borrowers requesting them to discuss their student loan experience. While GAO also analyzed other data, its findings should be viewed in light of this limited scope.

We appreciate the substantial time and effort that went into the audit and the opportunity to comment on the draft report. As FSA’s Acting Chief Operating Officer, I am pleased to provide below the Department’s responses to each of GAO’s three recommendations to the Secretary of Education.

Recommendation 1: The Secretary of Education should seek legislation to strengthen schools’ accountability for student loan defaults, for example, by 1) revising the cohort default rate (CDR) calculation to account for the effect of borrowers spending long periods of time in forbearance during the 3-year CDR period, 2) specifying additional accountability measures to complement the CDR, for example, a repayment rate, or 3) replacing the CDR with a different accountability measure.

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Response: We do not concur with this recommendation, and we previously have discussed our concerns with this type of recommendation with GAO representatives. From a separation of powers perspective, the Department as an executive agency has a responsibility to implement, not draft, statutes. If GAO believes this legislation is needed, this recommendation is best addressed as a matter to Congress, which has the authority and responsibility to draft and enact legislation. This is precisely how GAO handled this same type of recommendation in its report to Congress in 1999. Congress has begun efforts to reauthorize the Higher Education Act. Already, the House Committee on Education and the Workforce has reported out a bill, which, if enacted, would replace the Cohort Default Rate (CDR) now established in law with an entirely different accountability metric.

Recommendation 2: The Chief Operating Officer of the Office of Federal Student Aid should require that schools and default management consultants that contact borrowers about their federal student loan repayment and postponement options after they leave school present them with accurate and complete information. This could be done, for example, through a Dear Colleague Letter or another method.

Response: While we have reservations about the analysis on which GAO bases its recommendation and the extent of our authority to require schools to contact borrowers, or to refrain from doing so, we do believe that providing additional information to institutions could be helpful and, consequently, we partially concur with the recommendation. The Department cannot impose requirements on schools and their consultants without further authority and not through, for example, a Dear Colleague Letter. The Department could, however, provide information to schools and their consultants on best practices in this area.

In its study, GAO found a limited number of consultants engaged in some practices that GAO believed encouraged borrowers at risk of default to seek forbearance over other repayment options as a means to avoid default. Although GAO acknowledges that its report is based on a non-generalizable sample (including an interview of only 11 borrowers), GAO nevertheless concludes that the practices it observed may have led borrowers to incorrectly assume that forbearance was the only option or to misunderstand the financial consequences of forbearance, and that those practices represented a missed opportunity for borrowers to learn about other repayment options.

While critical of a few consultants' practice of sending forbearance applications to borrowers, GAO fails to acknowledge that the forbearance application itself provides an opportunity for borrowers to learn about other repayment options. In particular, the form advises applicants about other repayment options and benefits and includes a link to FSA's website for additional information. Specifically, the following is presented on the form:

Instead of forbearance, you may want to consider requesting a deferment (which has an interest benefit for some loan types) or changing to a repayment plan that determines your monthly payment amount based on your income. Visit StudentAid.gov/IDR for more information.

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determines your monthly payment amount based on your income. Visit StudentAid.gov/IDR for more information.

The forbearance form also provides an explanation to the applicant of the additional costs that a borrower may incur due to interest that may accrue and capitalize and includes examples to help the borrower understand the consequences.

In addition, while the draft GAO report includes an example of the additional interest cost incurred by a borrower using forbearance to avoid default, it does not discuss the potential additional interest cost incurred with the other repayment plans that provide, or may provide, lower monthly payments. For example, extending GAO's hypothetical case of a borrower with \$30,000 in loan debt such that the borrower consolidated to extend his or her repayment period, a 20-year repayment period would lower the borrower's monthly payment from \$328.56 to \$209.77. In so doing, however, a borrower would pay an additional \$10,918 in interest over the life of the loan compared to a 10-year repayment period, or over \$4,000 more than the borrower in the GAO's example of a borrower who opts for forbearance for 3 years. Depending on the particular circumstances of a borrower, an income-driven repayment option could even be more costly over the entire life of a loan for the borrower.

GAO concludes that, although forbearance can help borrowers avoid the negative consequences of default it may increase a borrower's lifetime loan cost, while reducing the usefulness of the cohort default rate to hold schools accountable. However, as the above examples illustrate, alternatives to forbearance may have the same consequences. In other words, all options have consequences for borrowers. GAO's analysis does not appear to balance the costs to borrowers, including the avoidance of default, against the benefit of increasing the rigor of the cohort default rate as a measure of institutional accountability.

Moreover, in making its recommendation, GAO did not consider other available and relevant data, including, for example, the extent to which borrowers enter income-driven repayment plans within an institution's CDR window and the fact the number of borrowers in income-driven repayment has increased several-fold over the course of the past several years. These data would be critical to consider in determining whether there has been overreliance on forbearances in the past, and if so whether it is ongoing, or whether any problem in this area is being remedied over time in light of the availability of new repayment options and the impact of ongoing outreach efforts.

While GAO indicates that the overall forbearance rates it calculated would have been lower if it had excluded periods of forbearance that are applied for administrative reasons, such as borrowers enrolling in income-driven repayment plans, we believe this point bears repeating in the report when general forbearance rates are discussed to avoid overstating the extent to which third parties may have a bearing on the overall forbearance rate.

Further, while GAO analyzed shorter- versus longer-term forbearance usage in its report, it is unclear what effect, if any, the consultants may have had with respect to encouraging borrowers to seek consecutive forbearances. This is important given that forbearances

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are approved for no longer than 12 months after which borrowers must reapply. In addition, comparing the forbearance usage of the institutions who hired third parties whom GAO found encouraged borrowers to postpone payments with those who did not so encourage borrowers would have provided a better understanding of the potential impact of such practices.

Despite our reservations about GAO's analysis and findings, we do agree that we should provide information about our expectations to institutions with respect to how they or their third-party servicers—with whom they are jointly and severally liable—counsel borrowers about their repayment options. In particular, we believe that institutions should begin by providing accurate and complete information about all repayment options neutrally and at a summary level, allow the borrower's stated preference for any given repayment option to guide the ultimate direction of the conversation, and that the information provided be free from financial incentive, be that in the form of a gift card or any other mechanism. Therefore, we will ensure that institutions are made aware of this information with respect to counseling borrowers in repayment for those institutions that choose to counsel borrowers themselves or through third parties.

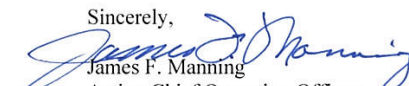
Recommendation 3: The Chief Operating Officer of the Office of Federal Student Aid should increase the transparency of the data Education publicly reports on school sanctions by adding information on the number of schools that are annually sanctioned and the frequency and success rate of appeals.

Response: The Department concurs with this recommendation.

In the interest of transparency, we currently make publicly available a significant amount of data concerning CDRs. For example, we routinely post to the FSA's website the CDRs and data underlying the calculation of the CDRs for the thousands of institutions for which the rates are calculated. We also provide data about the characteristics of these institutions. Moreover, we provide a listing of schools subject to sanction as a consequence of their CDRs, and a searchable database that allows a user to look up an institution's CDR and underlying data, and whether an institution had submitted an appeal and is no longer subject to sanction as a result of its CDR(s). In the future, for institutions subject to sanction, we will add to our website information on whether such institutions have submitted appeals and the disposition of such appeals. We will begin providing such information on FSA's website with the release of the fiscal year 2015 official CDRs.

I appreciate your work on this important issue and appreciate the opportunity to provide our comments.

Sincerely,



James F. Manning
Acting Chief Operating Officer

Appendix V: GAO Contact and Staff Acknowledgments

GAO Contact

Melissa Emrey-Arras, (617) 788-0534 or emreyarrasm@gao.gov

Staff Acknowledgments

In addition to the contact named above, Kris Nguyen and Debra Prescott (Assistant Directors), Brian Schwartz (Analyst-in-Charge), Alex Galuten, Raheem Hanifa, John Karikari, Kirsten Lauber, Jeffrey G. Miller, John Mingus, Jeff Tessin, Khristi Wilkins, and Stephen Yoder made key contributions to this report. Additional assistance was provided by Susan Aschoff, Rachel Beers, James Bennett, Deborah Bland, Jason Bromberg, Alicia Cackley, Marcia Carlsen, David Chrisinger, William Colvin, Sheila McCoy, Arthur Merriam, Jessica Orr, Ellen Phelps Ranen, Phillip Reiff, Barbara Steel-Lowney, and Christopher Zbrozek.

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