Federal Student Loan Servicing

Updated July 2021

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A primer on higher education loan servicing.

Federal student loans play a crucial role in ensuring access to an affordable higher education for millions of American students. According to the National Center for Education Statistics, more than 40 percent of first- time, full-time undergraduate students borrow for college. By the end of March 2021, the federal government held an outstanding student loan balance of $1.6 trillion, including $1.35 trillion in Direct Loans.

Student loan borrowers generally hold one or more of these types of loans: (1) federal student loans made directly by the U.S. Department of Education (ED) through the William D. Ford Direct Loan program (Direct Loans), (2) federal student loans previously made under the Federal Family Education Loan (FFEL) program, which are federally guaranteed,[1] and/or (3) private student loans. Though ED either directly awards or guarantees all federal student loans, it does not service the loans itself. Rather, ED contracts with private companies and organizations to handle loans in repayment. This primer begins with a general history of the federal student loan program and focuses on the servicing of Direct Loans.

History and Background of Federal Student Loans

The precursor to today's federal student loan program started under the Higher Education Act of 1965's Guaranteed Student Loan program, which was renamed the Federal Family Education Loan (FFEL) program in 1992. Under the FFEL program, ED encouraged private lenders to participate in the program by offering subsidies to those who participated. In addition to these subsidies, the government guaranteed that lenders would be compensated for a portion of their losses if a borrower defaulted. In 1993, Congress authorized the Direct Loan program, which allows students and their families to borrow directly from the federal government through ED with U.S. Treasury funds. With no lender subsidies to pay, this program reduced the government's cost of making a student loan.

For nearly 20 years, the Direct Loan and FFEL programs coexisted, with schools selecting which program to participate in and borrowers receiving nearly identical loan terms that were set in statute. In 2008, largely due to the credit crisis, several private lenders no longer found it feasible to participate in the FFEL program. To ensure the stability of the student loan market, ED offered to repurchase FFEL program loans from private lenders and absorb these loans into the Direct Loan program as part of the Ensuring Continued Access to Student Loans Act (ECASLA). These repurchased loans are referred to as "Department-held FFEL." In 2010, the Student Aid and Fiscal Responsibility Act (SAFRA) halted the availability of new FFEL program loans and mandated a complete switch to direct lending by June 30, 2010.[2] By March 2021, remaining FFEL program loans represented only one-sixth ($238.8 billion) of the $1.6 trillion in outstanding federal student loans. The remaining loan volume consisted of almost all Direct Loans ($1.35 trillion).[3]

As a result of the switch to direct lending, many see ED as one of the largest financial institutions in the United States. In fiscal year 2017, ED issued more than $132 billion in Direct Loans through 15.3 million loans. In fact, over the past ten years, ED's outstanding student loan balance has nearly doubled, from $750 billion at the end of fiscal year 2010 to $1.6 trillion at the end of fiscal year 2020.

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[1] FFEL loans were made by private banks, nonprofit organizations, and some state-affiliated lenders.

[2] SAFRA was passed as part of the Health Care and Education Reconciliation Act of 2010 (P.L. 111-152), which President Obama signed into law on March 30, 2010. It terminated the authority to make loans under the Federal Family Education Loan (FFEL) program after June 2010. For more information, see Congressional Research Service. (2010, April 14). The SAFRA Act: Education programs in the FY2010 Budget Reconciliation. Washington, DC: Author. Retrieved from http://doyle.house.gov/sites/doyle.house.gov/files/documents/Education%20SAFRA%20summary%20CRS%20report%20R41127.pdf.

[3] Perkins Loans totaled $4.7 billion. Institutions of Higher Education (IHEs) technically handle the servicing of Perkins Loans. However, some IHEs contract with outside entities. For more information, see https://studentaid.gov/understand-aid/types/loans/perkins

FIGURE 1. DEFINITIONS OF KEY STUDENT LOAN STATUSES

Default – Failure to repay a loan according to the terms agreed to in the promissory note. For most federal student loans, borrowers will default if they have not made a payment in more than 270 days. However, FSA generally identifies defaulted loans as those that are 360 days or more past due, because loan servicers have additional time to transfer Direct Loans to FSA's Debt Management & Collections System.

Deferment – A postponement of payment on a loan that is allowed under certain conditions and during which interest does not accrue on Direct Subsidized Loans, Subsidized Federal Stafford Loans, and Federal Perkins Loans. All other federal student loans that are deferred will continue to accrue interest. The most common type of deferment is for borrowers enrolled in school but borrowers can also receive deferments if they are experiencing a period of economic hardship or active military duty. Any unpaid interest accrued during the deferment period may be added to the principal balance (capitalized) of the loan(s).

Delinquent – A loan is delinquent when loan payments are not received by the due dates. A loan remains delinquent until the borrower makes up the missed payment(s) through payment, deferment, or forbearance

Forbearance - A period during which monthly loan payments are temporarily suspended or reduced. Forbearance may be granted to borrowers willing but unable to make loan payments due to certain types of financial hardships. Also, borrowers applying for an income-based repayment plan are placed on administrative forbearance. During forbearance, principal payments are postponed but interest continues to accrue. Unpaid interest that accrues during the forbearance will be added to the principal balance (capitalized) of loan(s), increasing the total amount owed.

Grace Period - The period of time after borrowers graduate, leave school, or drop below half-time enrollment where they are not required to make payments on certain federal student loans. Six months is the standard grace period. Some federal student loans will accrue interest during the grace period, and if the interest is unpaid, it will be added to the principal balance of the loan when the repayment period begins.

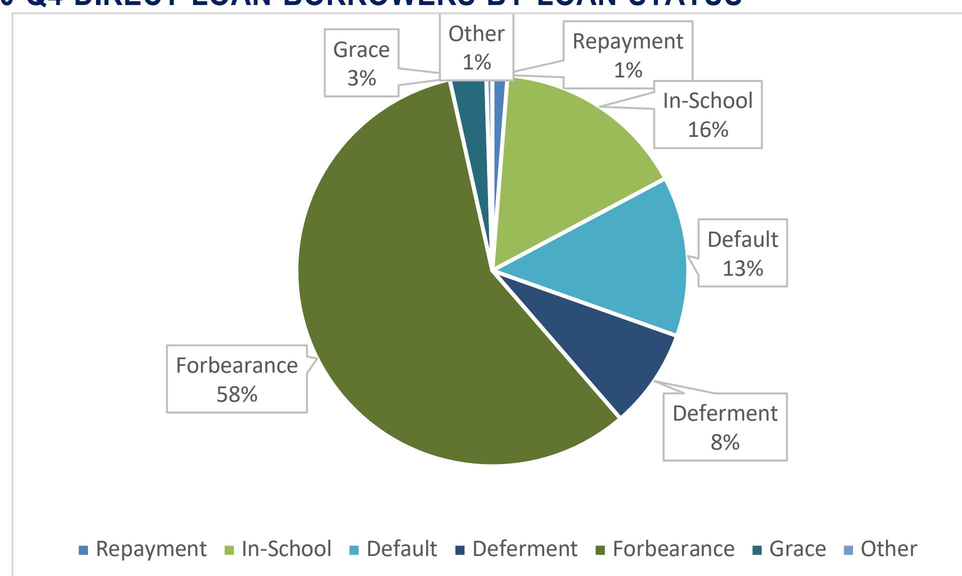
Repayment - Following the grace period, borrowers pay off the balance of their loans. Borrowers may select one of several pre-defined repayment plans, including a standard 10-year plan or an income-based repayment plan, or negotiate an alternative repayment plan with their loan servicer.

Source: Adapted from the glossary available at https://studentaid.ed .gov/sa/glossary

ED uses something called a loan status to describe a borrower's current stage of repayment (described in Figure 1). In response to the COVID-19 pandemic, Congress and ED placed most borrowers in an interest-free forbearance, allowing them to defer payments on their loans through at least September 30, 2021. As Figure 2 shows, by the end of the second quarter of fiscal year 2021 (March 31, 2021), only 1% of Direct Loan borrowers (500,000) are in repayment, 16% (6.4 million) are enrolled in school or within their loan's grace period before repayment starts, and 66% (26.5 million) have received either a deferment or forbearance. Thirteen percent of borrowers (5.3 million) are in default status.[4] Prior to the pandemic forbearances, at the end of the first quarter of the fiscal year, 49% (19.3 million) were in repayment and 15% (6 million) were in deferment or forbearance.

While the number of borrowers in deferment or forbearance status may seem alarming, [not all deferments and forbearances are inherently bad](). Most borrowers with deferments are enrolled in school and will eventually pay back their loans (Figure 3 shows the types of deferment borrowers received prior to the onset of the COVID forbearance). Borrowers receiving the COVID forbearance are also not accruing interest during the pandemic forbearance period, and the forbearance will count toward Public Service Loan Forgiveness and income-driven repayment forgiveness for otherwise- qualified borrowers. Delinquencies, however, are concerning. Ranging from 31 to 360 days behind on payment, delinquency is the last stop for a loan before it goes into default status and is transferred to debt collection. Figure 4 shows the delinquency statuses of Direct Loan borrowers prior to the onset of the COVID forbearance to provide an illustration of typical delinquency patterns.

FIGURE 2. FY2020 Q4 DIRECT LOAN BORROWERS BY LOAN STATUS



Source: National Student Loan Data System (Q2, 2021).

[4] ED's Federal Student Aid Portfolio Summary contains this note: "While technical default is 271 days delinquent, default is defined as 361 days delinquent for reporting purposes to ensure consistency with Federal Family Education Loans (FFEL) reporting."

FIGURE 3. DIRECT LOAN PORTFOLIO BY DEFERMENT TYPE

Includes outstanding principal and interest balances of Direct Loans in a deferment status

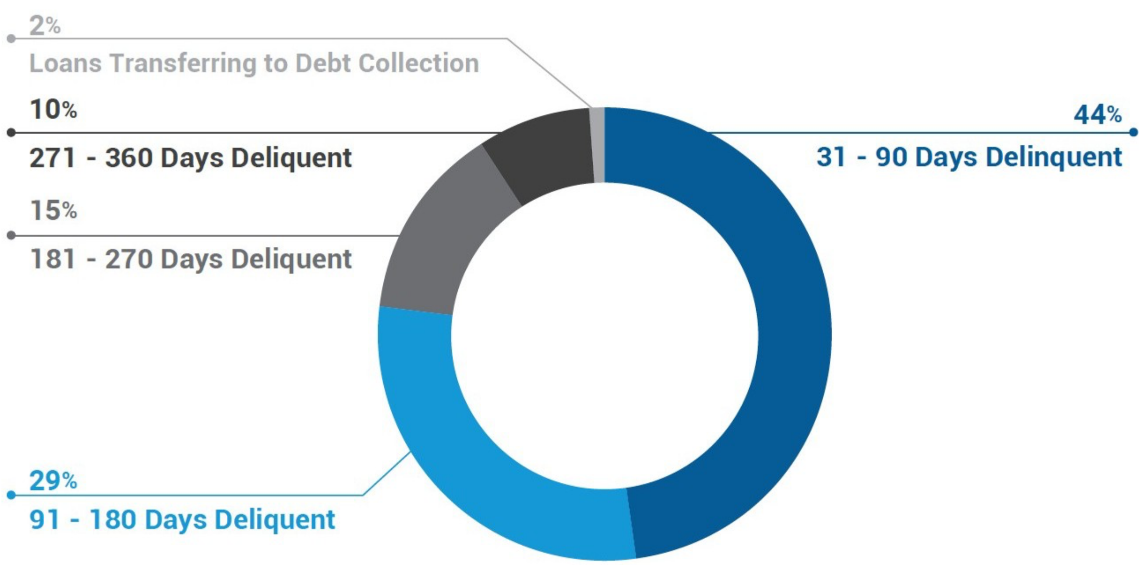
Federal Fiscal Year		In-School Deferment		Six-Month Post-Enrollment		Unemployment		Economic Hardship		Military		Other	
		Dollars Outstanding	Recipients	Dollars Outstanding	Recipients	Dollars Outstanding	Recipients	Dollars Outstanding	Recipients	Dollars Outstanding	Recipients	Dollars Outstanding	Recipients
2020	Q1	$97.9	2.92	$6.6	0.16	$6.1	0.14	$3.5	0.09	$0.2	0.01	$0.6	0.00
	Q2*	$115.7	3.21	$6.6	0.17	$6.9	0.16	$3.5	0.09	$0.2	0.01	$0.8	0.00
	Q3*	$101.0	2.87	$9.8	0.19	$0.0	0.00	$0.0	0.00	$0.0	0.00	$0.2	0.00
	Q4*	$102.3	2.95	$12.0	0.25	$0.0	0.00	$0.0	0.00	$0.0	0.00	$0.1	0.00

Source: National Student Loan Data System (Q4 2020). Dollars in billions; recipients in millions.

** FSA reports this note with its data: Changes to borrower accounts as a result of the administration's executive action in late March 2020, and provisions in the CARES ACT, which was signed on March 27, 2020, are underrepresented in FY2020 Q2 due to the timing of this report. Beginning in FY2020 Q3, loans in non-school-related deferments were placed in a mandatory administrative forbearance as a result of the CARES Act.*

Note: Some types of deferments, like in-school and six-month post-enrollment deferments, vary considerably based on the quarter measured and its alignment with the traditional academic year calendar.

FIGURE 4. FY2020 Q2 DIRECT LOAN BY DELINQUENCY STATUS (OF DELINQUENT LOAN DOLLARS THAT HAVE ENTERED REPAYMENT)



Source: National Student Loan Data System (Q2, 2020). Pre-pandemic data provided to illustrate typical delinquency status patterns.

Federal Student Loan Servicers

The U.S. Department of Education contracts with private entities (both non-profit and for-profit) to carry out much of the day-to-day operation of the student loan program. One group of these private entities—student loan servicers—facilitates repayment of the more than 30 million borrowers' Direct Loans, as well as department-held FFEL program loans.

Why does ED contract with private entities for loan servicing? In the 1980s, President Reagan used executive orders to enhance the use of government contractors. Work not inherently governmental was ordered to be contracted out to the private sector. He argued that it was less expensive and more efficient for the federal government to contract services. In this spirit, ED contracted out the servicing of Direct Loans from the program's inception and has continued to do so.

What are the department's responsibilities if contractors service loans? The Office of Federal Student Aid (FSA) is involved in the pre-contract award, the post-contract award, and ongoing monitoring of servicers. During the pre-award phase, FSA writes requests for proposals and reviews submissions from vendors. Once contracts are awarded, FSA manages the transition between vendors so that borrower information is properly transferred. FSA also manages the close-out process where vendors properly dispose of borrower records and data. Ongoing monitoring activities include reviewing compliance with ED business rules and federal regulations, site visits, and recorded conversations with borrowers. FSA also issues requests to loan servicers to make modifications to existing loan servicing contracts. Except in extreme circumstances, FSA has no contact directly with borrowers.

Loan servicers are the primary point of contact between borrowers and the federal government once a student borrower leaves school. The functions conducted by loan servicers include:

- Communicating with borrowers about their repayment date and the status of their loans;
- Collecting and tracking student loan payments;
- Guiding borrowers into appropriate repayment plans;
- Consolidating student loans;
- Determining eligibility for loan forgiveness programs, such as Public Service Loan Forgiveness;
- Processing requests for deferment or forbearance;
- Reporting data to the National Student Loan Data System (NSLDS) and credit agencies;
- Providing tax forms to borrowers;
- Assisting borrowers who wish to make extra payments (i.e., prepay) and ensuring that those payments are properly credited to borrowers' accounts; and
- Helping delinquent borrowers repay their Direct Loans by ensuring they are aware of the various options under the Higher Education Act for restoring loans to good standing.

An important function of loan servicers is to prevent borrower default. Servicers handle student accounts from when the borrower is in school, through grace periods and repayment, until the borrower repays the loan (see Figure 5) as long as the borrower remains in a non-default status. A borrower is delinquent if he or she has missed payments for 31–270 days, and is defined as in default after missing payments for more than 270 days.

Preventing default requires servicers and their employees to perform common default prevention techniques, including contacting delinquent borrowers by phone or postal mail and educating them about repayment programs. Servicers use a process known as skip tracing to track down delinquent borrowers by obtaining borrower contact information from schools attended, credit bureaus, and other sources. Loan servicers receive no payments when a borrower enters default and may temporarily hold almost-defaulted loans to allow borrowers to resume payments and prevent a default from appearing on the borrower's credit record.

Generally, loan servicers have 90 days to report default status to ED, after which time the borrower is officially classified as having defaulted in ED's records. Once a borrower defaults, an automated process transfers the loan from the servicer to ED's Debt Management and Collections System. The borrower is then contacted by a collection agency under contract with ED. Collection agencies and loan servicers are under separate contracts with ED and generally are not the same entities.

FIGURE 5. STEPS IN THE LIFE OF A DIRECT LOAN

1. Borrower submits completed **FAFSA** and the **Student Aid Report** (including Expected Family Contribution) is generated.
2. Schools listed on the borrower's FAFSA send **financial aid packages**, which may include Direct Loans, to the borrower.
3. Borrower accepts the school's admission offer and financial aid award, including the Direct Loan, bysigning the **promissory note**.
4. After the borrower completes **entrance counseling**, the school disburses the Direct Loan. The borrower's loan status is **"In-School"**.
5. Once the borrower leaves school (or drops below half-time enrollment), the borrower's loan status is **"InGrace"**. The borrower has **exit counseling**.
6. Once the grace period ends, the Direct Loan becomes **"In Repayment"**, unless the loan servicer approvesa deferment or forbearance.
7. Under the **Standard Repayment Plan**, the borrower will pay back the Direct Loan in 10-year equal installment payments. **Income-Based Repayment** plans offer longer term and **loan forgiveness** is available to qualified borrowers. During repayment, the borrower will work with an assigned federal loanservicer.
8. If the borrower fails to make payments for 360 days, the borrower is considered **"In Default"** and theDirect Loan is transferred to **debt collection**.

Unlike other consumer financial products (mortgages, credit cards, and car loans, etc.), federal student loan servicers are not selected by borrowers. A borrower's federal student loan is assigned to a loan servicer by ED. Under the FFEL program, when private lenders originated federal student loans, a borrower may have had more than one loan servicer. More recently under the Direct Loan program, ED's loan origination system uses Social Security numbers and name information to recognize borrowers with previously originated loans and assigns them to the same servicer. There may be, however, a small number of cases where borrowers' last names or Social Security numbers do not match (i.e., due to marriage or data entry errors) and they are assigned to more than one servicer. Unfortunately, these "split borrowers" may not realize they are failing to repay some of their student loans. In addition, ED assigns borrowers enrolled in certain programs to specific servicers, meaning that the borrower may see a change in who services their loans as they enroll in different repayment programs. For example, the Pennsylvania Higher Education Assistance Agency (PHEAA) services all borrowers enrolled in the Public Loan Forgiveness Program and Nelnet services loans held by all borrowers with a Total and Permanent Disability discharge. The only instance in which a borrower may choose their servicer under the current system is if they consolidate their loans. Then the borrower may pick from among the four loan servicers, collectively referred to as the Title IV Additional Servicers (TIVAS).

Another safeguard against borrower default happens at institutions of higher education (IHEs). They may partner with default management companies when students transition into repayment by assisting with debt management and default prevention. In fact, IHEs have an incentive to work with servicers. The Higher Education Act holds IHEs responsible for the repayment of their student borrowers' loans through the use of a federal cohort default rate, one of many factors that determines an IHE's continued eligibility to participate in Direct Loan programs. Schools are unable to participate in the Direct Loan program if their three-year federal cohort default rate is 30% or above for three consecutive years (or 40% or greater in a single year). A 2018 GAO analysis found that some of the default management companies with which institutions may contract sometimes acted outside of the interest of students, offering them information on forbearances rather than on the more paperwork-intensive—but potentially more favorable to the student—income-based repayment options available to students.

Servicer Contracts

Until 2009, ED had a contract with a single company, ACS Education Solutions, LLC, to service loans issued under the Direct Loan program. At the same time, loans in the FFEL program were serviced separately by private lenders. When ED acquired FFEL loans under ECASLA following the credit crisis, ED needed additional federal student loan servicers in the Direct Loan program.

In June 2009, ED entered into contracts with the four TIVAS. In 2010, SAFRA required that ED also enter into new contracts with not-for-profit (NFP) student loan servicers.[5] Starting in October 2011, NFP servicers began servicing federal student loans and were typically allocated 100,000 borrower accounts each. In total, there are eight private companies and non-profit organizations currently servicing Direct Loans and department-held FFEL program loans, as shown in Figure 6.[6]

FIGURE 6. FEDERAL STUDENT LOAN SERVICERS

Title IV Additional Servicers (TIVAS)	Not-For-Profit (NFP) Servicers
• Great Lakes Educational Loan Services (Great Lakes) • Navient (formerly known as SLM Corporation/Sallie Mae) • Nelnet Servicing, LLC (Nelnet) • FedLoan Servicing (Pennsylvania Higher Education Assistance Agency – PHEAA)	• HESC/Edfinancial[7] • Granite State Management & Resources (GSM&R) • Missouri Higher Education Loan Authority (MOHELA) • Oklahoma Student Loan Authority (OSLA Servicing)

Source: U.S. Department of Education. Retrieved from: https://studentaid.ed.gov/sa/repay-loans/understand/servicers#my-servicer.

[5] SAFRA provided mandatory funding for the NFP servicers from fiscal year 2010 through fiscal year 2019. This mandatory funding wasrepealed in 2013 by the Bipartisan Budget Act. Currently, loan servicing is funded by discretionary appropriations.

[6] On July 15, 2016, ED announced that one not-for-profit servicer, VSAC Federal Loans, recently requested to cease operations as a member of the federal loan servicer team. VSAC is not included in the total number of servicers. In August, ED transferred VSAC's loan accounts to Nelnet.See http://ifap.ed.gov/eannouncements/081516LSIFederalLoanServicerTeamChangeUpdateContactCenterSupportServiceStatus.html. In October 2020, another servicer (CornerStone) announced it was terminating operations; ED transferred its 1.1 million borrower accounts to PHEAA, from which CornerStone had licensed its servicing platform.

[7] On August 17, 2016, ED announced that ESA/Edfinancial changed its name to HESC/Edfinancial.

The number of borrowers served and the amount of student loan funds outstanding varies considerably between the TIVAS and the NFP loan servicers. As Figure 8 shows, as of December 2019 and before the COVID-19 pandemic, the TIVAS all had at least 3.8 million borrowers in repayment, with PHEAA having the most borrowers in repayment (5.3 million). The NFPs ***combined*** have only about 2.8 million borrowers in repayment and 7.3 million borrowers in their portfolios.

FIGURE 7. SERVICER PORTFOLIO BY LOAN STATUS

Includes Direct Loans and ED-owned Federal Family Education Loans

	In-School		Grace		Repayment		Deferment		Forbearance		Other	
Servicer	Dollars Outstanding	Recipients	Dollars Outstanding	Recipients	Dollars Outstanding	Recipients	Dollars Outstanding	Recipients	Dollars Outstanding	Recipients	Dollars Outstanding	Recipients
PHEAA	$19.4	0.87	$4.8	0.18	$261.0	5.32	$30.2	0.73	$49.8	0.84	$3.2	0.05
Great Lakes	$27.2	1.44	$5.7	0.25	$165.3	4.88	$27.1	0.80	$28.0	0.68	$2.0	0.04
Nelnet	$20.9	1.04	$4.4	0.19	$126.6	3.79	$22.6	0.67	$17.3	0.43	$1.4	0.03
Navient	$15.9	0.74	$3.7	0.15	$152.7	4.08	$22.5	0.60	$30.2	0.59	$2.6	0.05
Not-for-Profit	$42.6	3.19	$5.8	0.39	$55.9	2.81	$16.3	0.68	$5.6	0.24	$0.5	0.02

Source: National Student Loan Data System Q1, 2020. Dollars Outstanding in billions; recipients in millions. Pre-pandemic data used to better illustrate the differences in portfolios between TIVAS and NFP servicers.

Under 2014 contracts with the TIVAS and NFP loan servicers, ED provides servicers with broad latitude to determine how to service the federal student loans in their assigned portfolios. ED uses a performance-based system with common metrics to measure servicer performance and a common methodology to allocate new loan volume.

As defined in their contracts, ED measures servicers' performance with five metrics, consisting of two customer satisfaction surveys and three borrower payment status statistics, as shown in Figure 8.[8] The metrics are weighted (as indicated by the percentage in parentheses in Figure 8). Every six months, ED ranks the servicers and allocates new loan volume based on their ranks. Notably, ED's system does not establish minimum benchmarks for loan servicer performance. The metrics and the methodology for loan allocations are based on relative performance and can provide even the lowest-performing TIVAS or NFPs with additional loan accounts.

[8] From 2009 until the contract modifications in 2014, FSA used a postsecondary school survey to measure school officials' satisfaction with the servicers.

For several years, ED ranked the TIVAS and the NFP loan servicers apart from each other. That is, the performance of TIVAS was not compared to the performance of NFP servicers in allocating new loans due to variations in the loan portfolios. Until 2015, NFP servicers were not allocated newly originated loans, but instead received a one-time allocation of loans that were more stable and mature (i.e., borrowers who were in repayment and current on their loans) than the loans allocated to TIVAS. With the passage of the Consolidated Appropriations Act of 2016, this practice changed. The new law, and subsequent appropriations bills, required ED to allocate new loans to servicers based on their performance compared to all servicers (TIVAS and NFPs combined) by March 1, 2016.

To account for the differences in the TIVAS and NFP servicer loan portfolios, ED developed a performance metric methodology that uses the existing five metrics but "subdivides the overall portfolio in terms of delinquency risk." ED announced new allocations and the new metrics methodology on July 15, 2016. Under this updated system, servicers receive points based on how they rank on five metrics within each of the three delinquency metrics for a total of 15 segments, as shown in Figure 8. The five segments are:

1. Borrowers with consolidation or parent PLUS loans;
2. Borrowers who graduated less than three years ago;
3. Borrowers who graduated three years or more ago;
4. Borrowers who did not graduate but left school less than three years ago; and
5. Borrowers who did not graduate but left school three years or more ago.

Servicers are assigned points based on their rank relative to other servicers for each segment within each delinquency metric. Weights and a "delinquency adjustment factor" are applied and servicers' scores are averaged over two performance periods.[9] ED then uses all of these data points to allocate new loans to the TIVAS and NFPs.

FIGURE 8. FEDERAL STUDENT LOAN SERVICING METRICS

1. **Borrower Satisfaction Survey –** Measures borrower satisfaction with servicers using a quarterly web-based survey of randomly selected borrowers **(35%)**.
2. **Current Repayment –** Measures the percentage of borrowers in the servicer's portfolio who are not more than 5 days delinquent **(30%)**.
3. **Delinquency –** Measures the percentage of borrowers in the servicer's portfolio who are more than 90 days but less than 271 days delinquent **(15%)**.
4. **Severely Delinquent Borrowers –** Measures the success of the servicer's default prevention efforts as reflected by the percentage of borrowers in the servicer's portfolio for whom a delinquency is more than 270 days and less than 361 days **(15%)**.
5. **FSA Manager Survey –** Measures the satisfaction of FSA and other federal personnel with services using a quarterly online survey **(5%)**.

Source: Office of Federal Student Aid. Retrieved from https://studentaid.ed.gov/sa/sites/default/files/fsawg/datacenter/servicer/12312017/ExplanationQuarterEnd123117.pdf

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[9] ED calculates the delinquency adjustment factor as such: "For the total portfolio of FSA-held borrowers in repayment, the delinquency rate foreach segment for each performance period is divided by the corresponding delinquency rate for the overall portfolio." ED then applies the delinquency adjustment factor this way: "For each servicer and each segment, the weighted score by segment for each performance period is multiplied by the corresponding delinquency adjustment factor for that segment to produce an adjusted weighted score by segment."

ED pays servicers a flat fee per month per borrower based on each borrower's loan status, at a total of more than $850 million per year. Servicers are paid more to manage borrowers in repayment and less to manage the most delinquent borrowers. The NFP loan servicers were paid higher rates than the TIVAS until September 2014, when ED modified the Direct Loan contracts to bring the TIVAS and the NFP under one contracting umbrella, in part to align the payment amounts made to each lender (current pricing available in Figure 10).

During the pandemic, servicers have negotiated a rate of $2.19 for borrowers in the mandatory administrative forbearance (not reflected in Figure 9). The department recently announced steps to allow the agency to extend the current contracts through December 2021 for the TIVAS and through March 2022 for the NFPs. However, the contracts cannot be extended again after that, and must instead go through a new process.

FIGURE 9. MONTHLY SERVICER COMPENSATION FOR EACH BORROWER, BY STATUS

Borrower Status	Rate Per Borrower
In Repayment (including all service members)	$2.85
6–30 Days Delinquent	$2.11
In Grace Period	$1.68
Deferment	$1.68
31–90 Days Delinquent	$1.46
91–150 Days Delinquent	$1.35
151–270 Days Delinquent	$1.23
In School	$1.05
Forbearance	$1.05
271–361+ Days Delinquent	$0.45
Source: Adapted from GAO (2016, May).	

Challenges and Issues with Loan Servicing

Government agencies, borrowers, and stakeholders have concerns about the design of the federal student loan servicing contracts and how ED manages the servicers. There are also concerns about the quality of performance of the loan servicers. To help better understand the issues with the current system, the Consumer Financial Protection Bureau (CFPB),[10] ED and the U.S. Department of the Treasury asked for feedback from the public on the student loan servicing industry in May 2015. Subsequently, the CFPB published *Student loan servicing: Analysis of public input and recommendations for reform*, a 151-page report detailing the more than 30,000 comments received from consumer groups, loan servicers, and other stakeholders. Some of the comments received by the CFPB, as well as additional recent challenges and issues, are outlined below.

Program Design

Preventing default, an important function of the loan servicers, requires that the loan servicing contracts align with the default prevention goals and policies of ED. In 2014, ED's Office of the Inspector General (OIG) reviewed ED's administration of student loan debt and repayment from fiscal years 2011 through 2014. Unfortunately, OIG found that ED did not have a coordinated strategy to prevent student loan default and did not explicitly establish default prevention activities in its contracts with the loan servicers. OIG recommended that ED develop and implement a process to monitor TIVAS subcontractor default prevention activities and conduct an analysis to compare default rates between borrowers serviced by private FFEL lenders and those serviced by TIVAS.

Related to preventing default, many advocates have drawn attention to the fact that borrowers may not have the financial education needed to understand the terms, benefits, and protections of their student loans, the available repayment plans, and the consequences of loan default. This dearth of financial education may impact servicers' efforts to effectively serve borrowers who may be uninformed. Schools that participate in the Direct Loan program are required to provide borrowers with entrance and exit loan counseling. To improve upon the impact of current counseling, some have suggested that schools expand the entrance and exit counseling they currently provide. Counseling could occur more frequently or a specific strategy, like ED's Financial Awareness Counseling Tool, could be required. In August 2016, ED announced a pilot program where schools may provide loan counseling for borrowers once a year, rather than only when the borrower takes out their first loan. Additionally, the department announced the creation of an "annual student loan acknowledgement" requirement for all borrowers in November 2019; the requirement was delayed during the pandemic and will be an annual requirement beginning with the 2021–22 award year.

Another criticism about the design of the current student loan servicing system is that many borrowers are confused about who services their student loans. Servicers often co-brand correspondence with their own logos and ED's logo. Borrowers not familiar with their loan servicers may mistakenly regard this correspondence as "junk mail" or "spam." Borrowers may also have more than one type of loan and may receive separate correspondence from the same companies about different loans, leading to confusion about which loans the correspondence refers to. For example, a borrower could hold a Direct Loan and a private loan that are both serviced by the same company but have different protections and repayment options. Some have called on ED to eliminate co-branding in favor of using only ED's logo and to create a one-stop or single payment and information portal for borrowers with information about all their loans.[11]

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10 Under the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Consumer Financial Protection Bureau (CFPB) has the authorityto examine nonbank private student lenders. In March 2014, the CFPB expanded its examination program to include nonbank student loan servicers of both federal and private student loans, causing some concern about whether CFPB was overstepping its authority.

11 As discussed below, ED issued a solicitation for a single platform for loan servicing.

Clearly, the number of federal repayment options also creates complexity for servicers and borrowers: the number of repayment options available to borrowers has increased from two to 15 in the past 15 years. Eight different loan forgiveness programs and over 35 different deferment and forbearance options also add complexity to effectively helping borrowers. Non-servicer groups have recommended streamlining the current repayment plans to allow borrowers and servicers to more easily understand the options.

Laws and regulations outside of education can also impact servicers' work. For example, the Telephone Consumer Protection Act (TCPA), which was designed to keep consumers from receiving unsolicited phone calls, limits federal student loan servicers' ability to call or text student borrowers using autodialing or pre- recorded messages. Servicers must have the "prior express written consent" of the called borrower. While the current master promissory note may contain sufficient borrower consent, loan servicers may need the consent of borrowers with older student loans. Changes to the TCPA in November 2015 exempted calls made by auto-dialing (robocalls) or using an artificial or prerecorded voice "solely to collect a debt owed to or guaranteed by the United States," giving student loan servicers and other debt collectors more leeway to attempt to reach borrowers. The Federal Communications Commission (FCC) later issued a ruling on August 11, 2016, capping the number of robocalls debt collectors can make to a cell phone to three per month to limit outreach that may be unwanted. According to a Washington Post article, some servicers contend that this restriction will hinder their ability to "fully assist student loan borrowers," whereas some advocates contended that unlimited robocalls would cause borrowers to endure unwanted calls and possibly incur large cell phone bills.

Quality of Performance Concerns

With regard to quality of performance concerns, borrowers may encounter undertrained customer service representatives, mistakes, and inconsistent practices by loan servicers. Consumer groups have documented numerous paperwork and logistical problems borrowers encounter in moving out of default and signing up for income-based repayment plans. For example, under the income-based repayment programs, borrowers are required to certify their income upon applying and then annually re-certify their incomes. A 2015 ED analysis found that nearly 60% of borrowers failed to re-certify on time, causing their monthly loan payments to skyrocket. Some blame the servicers for a lack of reminders while others noted that servicer processing delays caused missed payments, added fees, or the overuse of forbearance.

Schools and financial aid administrators have pointed to servicing problems involving a lack of transparency and standardization among loan servicers. Varying systems and terminology used by different servicers to collect information from schools and financial aid offices are inefficient and can lead to unnecessary defaults. For example, the process of seeking contact information for borrowers varies among servicers.

Credit reporting is another area where a lack of standardization leads to confusion and negative financial implications for borrowers. Some servicers report the subsidized and unsubsidized portion of loans separately for each academic year, while others report them together. If a borrower defaults and has the two portions listed separately, the borrower's credit report reflects multiple defaults rather than a single default on one student loan, resulting in a huge impact on a borrower's credit score.

Borrowers also may face difficulty in reaching some servicers' customer service representatives due to limited call center hours. In a May 2016 report, GAO interviewed a sample of 24 borrowers and found that borrowers had difficulty calling their loan servicers, particularly if the borrower and loan servicer were located in different time zones. GAO recommended that ED "implement a minimum standard for servicer call center hours."

To address concerns with the lack of standardization, financial aid administrators have recommended that ED put forth a common procedures and policies manual for the servicers to standardize procedures, clarify responsibilities, and ensure borrowers are served well.[12] Some servicers have also echoed this request, and the Consolidated Appropriations Act of 2016 required that ED develop one. A common manual could facilitate more efficient communication between schools and the loan servicers, potentially preventing defaults.

It has also been noted that loan servicers may not be financially incentivized to best serve borrowers. Some speculate that this has led servicers to allocate borrower overpayments in a way that maximizes the amount of interest and fees paid instead of maximizing payments toward the loan principal. In addition, some have commented that the loan servicing compensation structure rewards companies that minimize the length and complexity of their interactions with borrowers during each communication contact, decreasing the quality of these interactions for borrowers. In fact, the current financial structure does not provide extra payments for enrolling borrowers in income-driven repayment plans and does not provide additional compensation for helping at-risk borrowers before they become delinquent on their loans.

Finally, some have suggested that the metrics used to evaluate loan servicers and allocate new loans need to be revised. In its May 2016 report, GAO found that the performance metrics ED uses to evaluate servicers may not align with ED's compensation for servicers or its compliance requirements. GAO cited the example of servicers not taking the time to counsel borrowers on the Public Service Loan Forgiveness program, since it may result in the transfer of the borrower's loan to a specific servicer with no further compensation for the current servicer. The CFPB ombudsman has called for establishing a uniform set of metrics on student loan performance for all loans. Others have suggested that the metrics better define quality customer service.

In March 2015, President Obama signed the Student Aid Bill of Rights, a presidential memorandum, to begin a concerted effort to study and correct some of these flaws. It required ED, in consultation with the U.S. Department of Treasury and the CFPB, to issue a report on student loan servicing, among other topics. In October 2015, ED issued Strengthening the Student Loan System to Better Protect All Borrowers to outline statutory, regulatory and administrative recommendations to assist borrowers. Among other recommendations, the report called for exploring more effective entrance and exit student loan counseling, allowing for a multi- year recertification process for income-driven repayment plans, giving ED broader authority to obtain access to Internal Revenue Service SkipTrace data so that delinquent borrowers may be contacted, streamlining Total and Permanent Disability Discharge, creating limitations on marketing for federal loans and servicers, and improving credit reporting for student loans.

In late 2015, ED also announced that FSA would institute several billing statement changes and require additional disclosures by servicers. For example, servicers are now required to send an ED-branded email notice 35 days prior to every payment due date and every billing statement for borrowers in the Public Service Loan Forgiveness program must include the borrower's current number of qualifying payments toward the 120 required.

In April 2016, ED released its solicitation for a new loan servicing contract to replace the existing contracts. In July of that year, ED Under Secretary Ted Mitchell sent FSA's chief operating officer a policy memorandum, intended to provide policy direction for the contract procurement. A key element of the procurement would have created a single platform for servicing all federal student loans in an effort to ensure more consistency in borrowers' customer service experiences.

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12 The Fiscal Year 2016 Omnibus Appropriations legislation (passed December 18, 2015) required ED to develop a common manual for DirectLoan servicers by March 1, 2016. According to news reports, a spokesperson from ED stated, "Creating this common set of standards and requirements outside of the re-compete would be prohibitively expensive because each additional requirement would have to be negotiated and paid for across all of our current servicers separately." See Hefling, K. (2016, April 6). Education Department misses deadline to create loan servicing manual. *Politico Pro.* [Subscription required.]

Management Concerns

Federal watchdog organizations have raised concerns about ED's insufficient monitoring of calls between servicers and borrowers. A 2014 OIG review found that ED did not adequately monitor calls made to delinquent borrowers and recommended that ED confirm that the TIVAS are conducting appropriate telephone outreach activities. In 2015, the U.S. Government Accountability Office (GAO) presented testimony before the U.S. House of Representatives Subcommittee on Government Operations and Subcommittee on Higher Education and Workforce Training about the Office for Federal Student Aid's (FSA) oversight of its Direct Loan servicers. GAO found that FSA lacked a sound methodology for monitoring phone calls between servicers and borrowers and did not properly document its call monitoring. GAO recommended that ED implement a more rigorous methodology for reviewing recorded phone calls and better document phone call monitoring results. A 2018 GAO report and a 2019 OIG report found inadequacies in FSA's oversight of servicers, including insufficient monitoring of servicer phone calls and messages and failure to hold servicers accountable for known noncompliance.

Advocates for student borrowers have also expressed concerns over the lack of consumer protections student loans offer compared to some other consumer financial products. For many consumer credit products (mortgages, credit cards, car loans, etc.), federal law prescribes servicing standards and processes. Borrowers also have an opportunity to shop around for these types of loans. Student loan borrowers are not able to select a servicer and do not have a standardized set of protections. For example, GAO found that FSA did not provide clear and consistent instructions to its loan servicers on how to apply borrower over- or under- payments and what documentation is allowable for income-driven repayment plans, among other concerns. Stakeholders have suggested looking to the mortgage and credit card industries for examples of federal laws that provide stronger consumer protections. These protections would include greater transparency on loan terms and conditions and better error resolution and payment processing requirements, such as how servicers should apply over-payments.

In addition, stakeholders and researchers have called attention to the need for better data to understand the impact of student debt, second only to mortgage debt as the largest source of household debt in the United States. In a 2015 *New York Times* article, economist Susan Dynarski stated, "The frightening reality, however, is that we are remarkably ignorant about student debt." Publicly available data is high-level summary statistics. In some cases, researchers do not have access to data at all (e.g., delinquency rates for each institution or loan type). Better data could enable servicers to target at-risk borrowers, potentially preventing defaults. In addition, some have suggested that the antiquated system that runs the NSLDS needs to be updated in order to better interface with schools and loan servicers' data systems and researchers' access to data. ED has made some data improvements, including constructing an enterprise data warehouse that uses more modern technology to facilitate analysis and research on federal aid questions.

Certainly, tracking issues and challenges in the form of borrower complaints has presented challenges for ED. In its May 2016 report, GAO noted that, while ED has improved its tracking of borrower complaints, ED lacks a systematic way to collect and resolve complaints. For example, GAO found that ED records borrower complaints in a dozen different systems and each of the 10 servicers also receives complaints in its own system. GAO recommended that ED "ensure its complaint tracking captures comprehensive and comparable information from servicers." The department has since constructed and made live a federal student aid feedback system. However, for several years (from 2017 to 2020), the department terminated and later reinstated an agreement with the CFPB to share complaints data.

Another debate in recent years has been the degree to which states have authority to license, regulate, and oversee federal student loan servicers in the course of enforcing their own consumer protection laws. In March 2018, Secretary of Education Betsy DeVos issued a "notice of interpretation" alleging that states are preempted by federal law and have very little authority to oversee servicers.[13] However, that notice has been largely opposed by many state governors, state attorneys general, lawmakers in Congress, and consumer advocates; and its legality has been called into question. The issue of state oversight is currently implicated in several pieces of litigation, including a recent court decision to strike down a D.C. servicing law and pending lawsuits against several other servicers on behalf of state AGs and borrowers.

Recent Reforms & Developments

Despite the fact that contracts for the current TIVAS were set to expire in 2019, the procurement put in motion by the Obama Administration was canceled midway through the process when the Trump Administration took office. In May of 2017, Secretary DeVos issued a new servicing procurement canceling the Obama Administration's recompete of the contracts. The proposal would have, among other things, hired one servicer to service all loans. While the department said doing so would reduce costs and ease the Federal Student Aid office's burden in overseeing the contracts, observers raised concerns about whether and how the department would hold that servicer accountable.[14]

In August 2017, the Department canceled this second procurement and instead announced the Next Generation Processing and Servicing Environment, a separate recompete of the servicing contracts that would use a single platform for multiple servicers (much like the 2016 solicitation would have), upgrade technology, and improve data reporting systems.[5] Following the selection of companies for the first phase of this Next Generation procurement, however, the companies not selected filed lawsuits about the procurement process that was used. Subsequently, the department announced through a court filing in December 2018 that it would cancel the second phase of the solicitation and issue a new one to correct the process. The department issued that new procurement in January 2019, which was quickly followed by lawsuits from several servicers.

Additionally, the department made a February 2019 award to Accenture to improve its website and other services for borrowers, including consolidating several websites.

In April and July 2020, ED again canceled two servicing-related procurements (for the student loan servicing platform and system, respectively). In October, the department released a new procurement for an Interim Servicing Solution (ISS), which would have awarded two five-year contracts similar to the existing ones. The ISS was intended to serve as a bridge until ED was able to complete its Next Gen procurement and build a new platform; and it would have reduced the number of servicers to ease oversight of the contractors. In December 2020, the Consolidated Appropriations Act of 2021 prohibited ED from awarding funding for any contract solicitation for Next Gen. As a result, FSA has put the Interim Servicing Solution solicitation on pause and plans to extend the contracts of existing loan servicers when they expire at the end of 2021.[15]

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***Acknowledgment**: PNPI would like to thank Rachel Fenton, the original author of this report, for her work on this publication. We would also like to thank Clare McCann, Deputy Director for Federal Higher Education Policy at New America, Ben Miller, Senior Director of Postsecondary Education Policy at the Center for American Progress, and Jason Delisle, Resident Fellow at the American Enterprise Institute, for providing expert comments, updates, and suggestions for this primer. In addition, we would like to thank David A. Bergeron, Senior Fellow for Postsecondary Education at the Center for American Progress, for his informative insights.*

Updated July 2021