Student Loan Servicing

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Summary

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% of first-time, full-time undergraduate students borrow for college. By the end of September 2022, the federal government held an outstanding student loan balance of $1.63 trillion, including $1.42 trillion in Direct Loans.[1] 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,[2] 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.

A Brief History 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, also known as the Federal Family Education Loan (FFEL) program. 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 implemented 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.[3] By September 2022, remaining FFEL program loans represented only 13% ($207.8 billion) of the $1.62 trillion in outstanding federal student loans. The remaining loan volume consisted of almost all Direct Loans ($1.41 trillion).[4]

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[1] The Congressional Budget Office estimates that the Biden Administration's decision to cancel between $10,000 and $20,000 in student debt for most borrowers would cost approximately $430 billion and significantly reduce the total outstanding balance. The Biden Administration estimates the cost over ten years at about $300 billion.

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

[3] 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 the Congressional Research Service report.

[4] 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.

Figure 1: Definitions of Key Student Loan Statuses

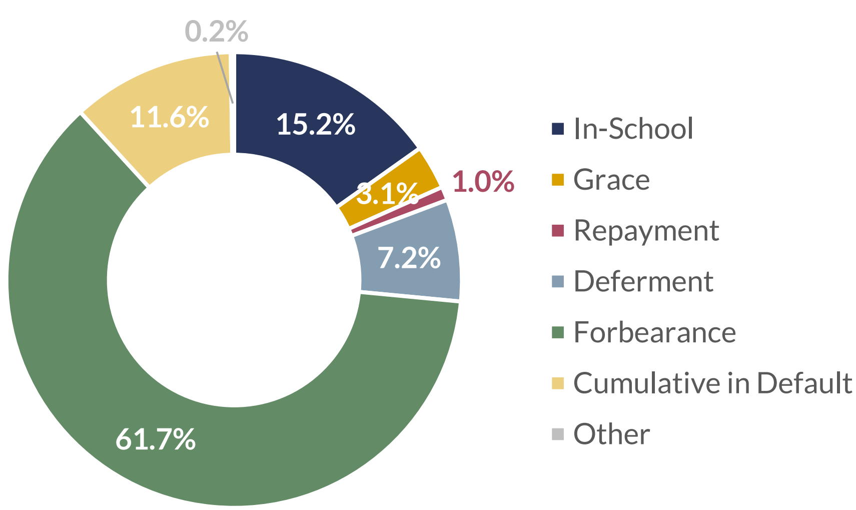
Default – Failure to repay a loan according to the terms agreed to in the promissory note. For most federal student loans, borrowers will default if they have not made a payment in more than 270 days. However, FSA generally identifies defaulted loans as those that are 360 days or more past due, because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

ED uses "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 January 31, 2022. The payment pause has since been extended multiple times—the latest plan put forward by the Biden Administration is to restart payments 60 days after the Supreme Court resolves the litigation over its student debt cancellation plan, or 60 days after June 30, 2023 if the court has not acted by that date. As Figure 2 shows, by the end of the fourth quarter of fiscal year 2022 (September 30, 2022), only 1% of Direct Loan borrowers were in repayment, 15% were enrolled in school or within their loan's grace period before repayment starts, and nearly 70% had received either a deferment or forbearance. Twelve percent of borrowers were in default status.[5] Prior to the pandemic forbearances, at the end of the first quarter of fiscal year 2020, 49% were in repayment and 15% 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-19 forbearance). Borrowers receiving the COVID-19 forbearance are also not accruing interest during the pandemic forbearance period, and the forbearance will count toward Public Service Loan Forgiveness (PSLF) 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-19 forbearance to provide an illustration of typical delinquency patterns.

Figure 2: FY2022 Q4 Direct Loan Borrowers by Loan Status



[5] 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

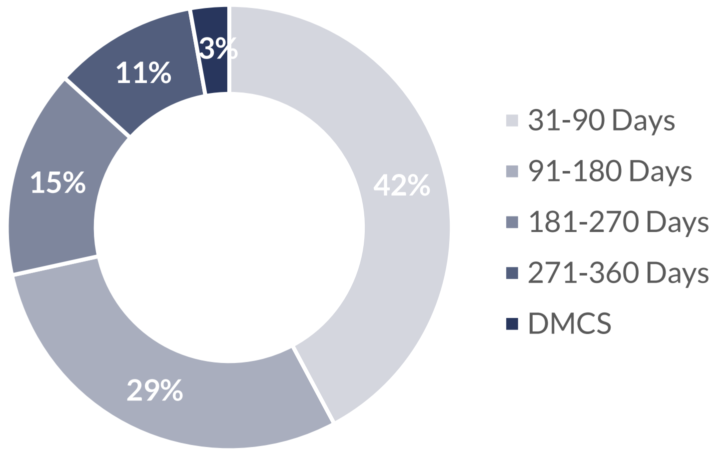
	In-School Deferment		Six Months Post-Enrollment		Unemployment		Economic Hardship		Military		Other	
Federal Fiscal Year	$	#	$	#	$	#	$	#	$	#	$	#
Q1, 2020	$97.9	2.92	$6.6	0.16	$6.1	0.14	$3.5	0.09	$0.2	0.01	$0.6	0.00
Q2, 2020	$115.7	3.21	$6.6	0.17	$6.9	0.16	$3.5	0.09	$0.2	0.01	$0.8	0.00
Q3, 2020	$101.0	2.87	$9.8	0.19	$0.0	0.00	$0.0	0.00	$0.0	0.00	$0.2	0.00
Q4, 2020	$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. # represents the number of loan recipients.

** 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.*

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

Figure 4: FY2020 Q2 Proportion of Total Delinquent Direct Loan Dollars by Delinquency Status



Federal Student Loan Servicing

The U.S. Department of Education contracts with private entities (both nonprofit 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 37 million borrowers' Direct Loans, as well as department-held FFEL program loans.

The impetus for ED's decision to outsource loan servicing to private entities dates to the 1980s. President Reagan used executive orders to expand the use of government contractors for work the administration deemed was not inherently governmental under the assumption that the private sector could perform it better for lower cost. In this spirit, ED contracted out the servicing of Direct Loans from the program's inception and has continued to do so.

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 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 the case of certain complaints, FSA has almost no direct contact with borrowers.

The Role of Loan Servicers

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 as long as the borrower remains in a non-default status (see Figure 5). A borrower is considered delinquent if they have missed payments for 31–270 days and enter default after missing payments for more than 270 days. However, 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.

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.

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, by signing 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 **"In Grace**." The borrower has **exit counseling**.
6	Once the grace period ends, the Direct Loan becomes **"In Repayment,"** unless the loan servicer approves a 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 payments and **loan forgiveness** is available to qualified borrowers. During repayment, the borrower will work with an assigned federal loan servicer.
8	If the borrower fails to make payments for 360 days, the borrower is considered **"In Default"** and the Direct Loan is transferred to **debt collection**.

Loan Assignment

Unlike other consumer financial products (mortgages, credit cards, and car loans, etc.), federal student loan servicers are not selected by borrowers in most cases.[6] 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 assign 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 Higher Education Loan Authority of the State of Missouri (MOHELA) services all borrowers enrolled in the Public Service 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.

[6] The one exception is a borrower who consolidates multiple loans.

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 four servicers known as TIVAS (Title IV Additional Servicers). In 2010, SAFRA required that ED also enter new contracts with not-for-profit (NFP) student loan servicers.[7] In October 2011, NFP servicers began servicing federal student loans and were typically allocated 100,000 borrower accounts each.

Over the past decade, two TIVAS and several of the NFP servicers have stopped servicing federal student loans for a variety of reasons. A combination of increased oversight from state and federal agencies, the cost of providing services, and an interest in focusing on other lines of business as a result of the first two factors contributed to their departures. Nelnet also purchased Great Lakes—another large TIVAS—further consolidating the program. There are now six servicers remaining that support Direct Loans and department-held FFEL program loans, as shown in Figure 6.[8] Recent servicer departures include the following:

- The Utah Higher Education Assistance Authority, which operated under the brand Cornerstone, left the program in 2020, transferring its 1.1 million borrowers to the Pennsylvania Higher Education Assistance Agency (PHEAA), also known as Fed Loan.
- PHEAA announced its departure the following year in 2021. It transferred its borrowers to a mix of other servicers and handed off the Public Service Loan Forgiveness Portfolio to MOHELA in September 2022.
- The New Hampshire Higher Education Loan Corporation (Granite State Management and Resources or GSMR) exited in 2021 and transferred its approximately 1.3 million borrowers to Edfinancial.
- Also in 2021, Navient transferred its federal student loan borrowers to Maximus—the ED's servicer for defaulted loans—under the brand name AidVantage.

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

[8] On July 15, 2016, ED announced that one not-for-profit servicer, VSAC Federal Loans, 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 of 2016, ED transferred VSAC's loan accounts to Nelnet. 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. On August 17, 2016, ED announced that ESA/Edfinancial changed its name to HESC/Edfinancial.

Figure 6: Federal Student Loan Servicers

Title IV Additional Servicers (TIVAS)	Not-For-Profit (NFP) Servicers
▪ Great Lakes Educational Loan Services (Owned by Nelnet) ▪ Nelnet Servicing, LLC ▪ AidVantage (Owned by Maximus)	▪ HESC/Edfinancial ▪ Missouri Higher Education Loan Authority (MOHELA) ▪ Oklahoma Student Loan Authority (OSLA Servicing)

Source: U.S. Department of Education.

In the past, TIVAS served many more borrowers and a larger total loan volume than the NFP servicers, though that has since changed because of consolidation among servicers and MOHELA's related expansion. As Figure 7 shows, each of the remaining TIVAS were servicing between 7.5 and 9 million loans as of September 2022. MOHELA also serves over 7 million borrowers, while the other two NPF servicers—HESC and OSLA—serve approximately 6 million borrowers.

Figure 7: Servicer Portfolios

Servicer	Dollars Outstanding (In billions)	Recipients (In millions)
PHEAA	$2.80	0.06
Great Lakes	$226.10	7.08
Nelnet	$352.80	9.76
AidVantage	$317.20	8.37
Not-for-Profit Servicers	$457.70	13.64

Source: FSA Data Center, September 2022. Dollars outstanding in billions; recipients in millions.
Notes: Includes Direct Loans and ED-owned Federal Family Education Loans.

Servicer Contracts

While ED enforces a range of operational requirements as cybersecurity, financial controls, and data reporting through servicer contracts, it also provides servicers with broad latitude to determine how to service the federal student loans in their assigned portfolios. Each servicer runs its own website and customer contact center, and exercises a large amount of discretion in developing its call protocols and borrower outreach strategies. There is no single back-end processing system, though some servicers use the same platform.

Previous Performance Metrics

Under its 2014 contracts, ED used a performance-based system with five metrics and a common methodology to allocate new loan volume.[9] A borrower satisfaction survey and the proportion of borrowers in repayment had the largest impact on the servicer's "score," comprising 35% and 30% of the performance measure respectively. Every quarter, ED ranked the servicers and allocated new loan volume based on their ranks.

Originally, the TIVAS were not compared to the performance of NFP servicers in allocating new loans due to variations in the loan portfolios. Until 2015, NFP servicers 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 NFP servicers combined) by March 1, 2016. To account for the differences in risk between the TIVAS and NFP servicer loan portfolios, ED developed a performance metric methodology that "subdivide[d] the overall portfolio in terms of delinquency risk." Servicers received points based on how they ranked on the five performance metrics within each of three delinquency risk tiers for a total of 15 segments. Weights and a "delinquency adjustment factor" were applied and servicers' scores were averaged over two performance periods.[10] ED then used all of these data points to allocate new loans to the TIVAS and NFP servicers.

2022 Updated Performance Metrics

Notably, the metrics and the methodology for loan allocations were based on relative performance, providing even the lowest-performing TIVAS or NFPs with additional loan accounts. As part of a two-year contract extension authorized by Congress in the Consolidated Appropriations Act of 2021, however, FSA revised its scoring system and can now deny additional loans to servicers who fail to meet a minimum standard.

Figure 8 lays out the complex set of factors FSA has been using to score servicer performance in FY2022 and FY2023. The new formula places a heavy weight on how servicers interact with borrowers including a customer satisfaction survey alongside reviews of the quality and accuracy of information provided at customer contact centers. Failure to meet a minimum standard for these "service level agreements" can result in FSA denying new loans to a servicer for a given review period. The second section of the formula uses a set of metrics to incentivize servicers to keep borrowers from falling behind on their payments, weighted for the delinquency risk of a servicer's portfolio. A servicer that ranks last in overall score for three out of four consecutive quarterly rankings can be denied new loans.

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

[10] ED calculates the delinquency adjustment factor as such: "For the total portfolio of FSA-held borrowers in repayment, the delinquency rate for each 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."

Servicers are also required to maintain core call center hours, including Saturdays, to make customer service representatives more accessible for borrowers and all six servicers are required to respond to complaints in a timely manner. The contract extensions expressly prohibit loan servicers from shielding themselves from lawsuits brought to hold the companies accountable in court for poor servicing practices. FSA also now requires servicers to provide new, comprehensive reports that give FSA greater insight into borrowers' experiences. The changes reflected in the new contract terms complement short-term changes being made to servicers' requirements for borrowers' transition back into repayment after the student loan repayment "pause" ends.

Figure 8: Federal Student Loan Servicing New Loan Allocation Metrics

Allocation Metrics	
1. 65%: Service Level Agreement Metrics ("SLA Metrics") - Total Weight	a. **25% Customer Satisfaction Survey**: Customer satisfaction surveys conducted at least quarterly measure borrower satisfaction with the servicer.
	b. **15% Abandon Rate**: The percentage of calls that are terminated by the caller before being answered by an agent.
	c. **15% Quality Monitoring**: The percentage of customer interactions that received a passing score from an FSA agent.
	d. **10% Accuracy Rate**: The percentage of tasks performed by the servicer and reviewed by FSA that were completed correctly the first time.
2. 35%: Portfolio Performance Metrics ("Portfolio Metrics") - Total Weight These metrics are measured by combining weighted rankings from each borrower segment.	a. **20% Percentage of borrowers current or less than 31 days delinquent.**
	b. **10% Percentage of borrowers 31-90 days delinquent.**
	c. **5% Percentage of borrowers 91-360 days delinquent.**

<table>
<tr><th colspan="2">Borrower Segments (Risk Weighting)
For each portfolio metric, the servicer will receive a score of the weighted rankings of each of the following borrower segments.</th></tr>
<tr><td colspan="2">1. 20%: Borrowers who previously defaulted</td></tr>
<tr><td rowspan="4">2. 35%: At-risk borrowers, defined as borrowers who:</td><td>a. Have not graduated and entered repayment since 2014; OR</td></tr>
<tr><td>b. Entered repayment for the first time within the last three years; OR</td></tr>
<tr><td>c. Exited hardship, unemployment, or natural disaster deferment or forbearance in the last four years; OR</td></tr>
<tr><td>d. In FY2022 any borrower who was more than 90 days delinquent during the year prior to the CARES Act payment pause. In FY2023 any borrower who was more than 90 days delinquent in the past year.</td></tr>
<tr><td colspan="2">3. 15%: Parent PLUS and Consolidation Borrowers</td></tr>
<tr><td colspan="2">4. 30%: All other borrowers</td></tr>
<tr><th colspan="2">Minimum Thresholds for Receiving New Loans
FSA reserves the right to withhold any new loan borrowers to servicers who have the lowest total score in three of four review periods or who fail to meet the following SLA metrics in a single review period:</th></tr>
<tr><td colspan="2">1. Customer Satisfaction Score: 70% Minimum</td></tr>
<tr><td colspan="2">2. Abandon Rate: No Higher Than 4%</td></tr>
<tr><td colspan="2">3. Interaction Quality Monitoring: 95% Minimum</td></tr>
<tr><td colspan="2">4. Accuracy Rate: 95% Minimum</td></tr>
</table>

Source: Office of Federal Student Aid.

Payment

ED pays servicers primarily through a flat fee per month for each borrower based on each borrower's loan status, at a total of more than $850 million per year. Monthly fees are higher for borrowers in repayment than for delinquent borrowers, with longer delinquency leading to lower fees (current pricing available in Figure 9). During the pandemic, servicers negotiated a monthly rate of $2.19 per borrower in the mandatory administrative forbearance (not reflected in Figure 9).

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 (May 2016).

Challenges and Issues with Loan Servicing

Challenges with the servicing system generally fall into three categories: program design, servicer quality, and ED's management of the program.

Program Design

The number of repayment options available to borrowers has increased from two to eight in the past 15 years,[11] creating complexity for borrowers and servicers. Moreover, eight different loan forgiveness programs and over 35 different deferment and forbearance options add to the challenges borrowers face in deciding how to manage their student debt. Non-servicer groups have recommended streamlining the current repayment plans to allow borrowers and servicers to more easily understand their options.

[11] This includes the following plans listed on FSA's website: Standard Plan, Extended Plan, Graduated Plan, PAYE, REPAYE, IBR, ICR, and ISR.

Many borrowers do not understand the terms, benefits, and protections of their student loans, the available repayment plans, and the consequences of loan default. The dearth of financial knowledge impairs servicers' efforts to effectively serve borrowers. Schools that participate in the Direct Loan program are required to provide borrowers with entrance and exit loan counseling, but it is not clear how effective these programs are, if at all. 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 became an annual requirement beginning with the 2021–22 award year.

Another criticism 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 improve clarity and access to loan servicers, with particular emphasis on a single payment and information portal for borrowers with information about all their loans.[12]

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 auto-dialing 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 pre-recorded 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 unwanted outreach. Some servicers contend that this restriction hinders their ability to "fully assist student loan borrowers," whereas some advocates counter that unlimited robocalls unfairly force borrowers to endure unwanted calls and possibly incur large cell phone bills.

[12] As discussed later in this primer, ED issued a solicitation for a single platform for loan servicing.

Servicer Quality Concerns

Servicer performance has garnered significant attention from federal agencies and outside advocates. Borrowers may encounter undertrained customer service representatives, mistakes, and inconsistent practices by loan servicers. Borrowers and researchers 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. A September 2022 report by the CFPB found that servicers continued to exhibit delayed processing times, failure to communicate about income recertification, and instances of providing inaccurate information about student loan repayment and forgiveness plans.

Schools and financial aid administrators have pointed to servicing problems involving a lack of transparency and standardization among loan servicers. This view emphasizes that 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, servicers use different processes for seeking borrower contact information.

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 larger impact on a borrower's credit score.

To address concerns with the lack of standardization, financial aid administrators have recommended that ED put forth a common policies manual for the servicers to standardize procedures, clarify responsibilities, and ensure borrowers are served well.[13] 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. As of January 2023, ED had yet to implement one.

In certain cases, loan servicers may not be financially incentivized to best serve borrowers. Some critics 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. Others have noted 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.

[13] The Fiscal Year 2016 Omnibus Appropriations legislation (passed December 18, 2015) required ED to develop a common manual for Direct Loan 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 (2016).

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.

Issues with the transfer of student loans recently arose with the exit of PHEAA and Granite State Management and Resources from the servicing program. More than 9 million borrowers were transferred from these two companies to other servicers. CFPB found that insufficient or inaccurate borrower information was transferred to new servicers preventing them from effectively servicing the loans. In some cases, communications to borrowers included inaccurate information about the borrowers' next payment due date. In multiple cases, these mistakes affected hundreds of thousands of people.

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 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 about FSA's 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. 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 to better interface with schools and loan servicers' data systems and allow 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.

Another debate in recent years has been the degree to which states have authority to license, regulate, and oversee federal student loan servicers while 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.[14] 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 Biden Administration later revised the notice in August 2021, determining that federal law preempts state law in this area in only a narrow set of circumstances.

Recent Developments

Federal student loan servicing has been at the center of several policy and administrative actions over the last several years. As part of the broader push to modernize systems at FSA, ED has tried and failed on multiple occasions to update the servicing system with new long-term contracts. As noted previously, multiple servicers have left the program. Meanwhile, a number of policy changes to student loans including the pandemic payment pause, temporary waivers of PSLF program rules, a new income-driven repayment plan, and the Biden Administration's attempt to cancel between $10,000 and $20,000 of most borrowers' debt will impact the servicing program.

A New Student Loan Servicing System

In May 2022, the Office of Federal Student Aid announced its latest plan for the reform of the loan servicing system—the Unified Servicing and Data Solution (USDS). USDS attempts to simplify the loan servicing process by streamlining access to all student loan servicers with federal contracts through the FSA-managed StudentAid.gov. The implementation was expected to occur after the current servicing contracts expire in December 2023.[15] However, Congress' did not adjust FSA's funding to account for inflation in the FY2023 appropriations process, which may alter the structure of the USDS or delay its implementation.

[14] See U.S. Department of Education (March 12, 2018).

[15] For more information on USDS, see Brink (2022).

This is the fifth time in six years that ED has attempted to establish a new student loan servicing system. FSA first announced a solicitation for a new student loan servicing system in April 2016 along with a memorandum from ED that laid out a vision for a single servicing platform, standardized communications, and stronger accountability. The Trump Administration retracted the memo a year later in April 2017 and amended the previous solicitation to bring on a single servicer to handle all federal student loans. While ED said doing so would reduce costs and ease FSA's administrative burden, observers raised concerns about whether and how the department would hold that servicer accountable.[16]

In response, ED canceled this second procurement in August 2017 and instead announced the Next Gen Initiative, an effort to modernize FSA's operational systems supporting federal student aid from the initial application all the way through to student loan repayment. As part of a broader set of solicitations in February 2018, FSA released a second solicitation for a new student loan servicing system known as the Next Gen Processing and Servicing Environment. The new contracts would use a single platform for multiple servicers (much like the 2016 solicitation would have), upgrade technology, and improve data reporting systems.[17] Following the selection of companies for the first phase of this Next Generation procurement, however, the companies who did not receive contracts filed lawsuits. ED 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. ED issued the new (third) procurement in January 2019, which was quickly followed by lawsuits from several servicers and another cancellation from ED in April and July 2020 (for the student loan servicing platform and system, respectively).

In October 2020, the department released a fourth 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 anticipation of changes to the system and citing financial sustainability concerns, CornerStone Education Loan Services announced they were terminating their contract with ED immediately. In December 2020, the Consolidated Appropriations Act of 2021 prohibited ED from awarding funding for any contract solicitation for Next Gen and authorized a two-year contract extension. As a result, FSA put the ISS solicitation on pause and extended the contracts of existing loan servicers through the end of 2023. Consistent with the appropriations language, ED also announced new standards for its student loan servicers beginning in January 2022 (detailed previously in the performance section). ED has not yet announced whether it intends to move forward with implementing a narrower version of a new servicing system beginning in January 2024 or whether it will seek another delay and extension of existing servicer contracts.

[16] See Campbell and Garcia (2017) and Barrett and McCann (2017).

[17] See Campbell (2018).

The Payment Pause and Proposed Debt Cancellation

In addition to the challenges in establishing a modernized student loan servicing system, a number of recent policy developments will place significant demands on student loan servicers in 2023. In the summer of 2022, the Biden Administration announced plans to cancel between $10,000 and $20,000 of student debt for all borrowers with incomes below $125,000 per year ($250,000 for couples). Were this policy to go forward, up to 20 million borrowers would have their remaining debt completely eliminated, significantly reducing the number of borrowers in the federal student loan system. If the administrative action moves quickly and smoothly, it could ease the burden on servicers when restarting the pandemic payment pause. However, several court challenges quickly halted implementation of the debt cancellation, and the Supreme Court is now reviewing the case. Further delays could bring additional systemic burdens as more borrowers call their servicers with questions about why they have not yet seen their loans canceled. A Supreme Court decision to block debt cancellation entirely could also lead to widespread confusion among borrowers who did not expect to need to repay loans, placing further demands on the servicing system.

After the Supreme Court announced it would hear the case, the Biden Administration announced the latest of several extensions of the pandemic payment pause on all federal student loans, first implemented through the CARES Act in 2020. The new plan is for the pause to end 60 days after the Supreme Court renders judgment on the case or on August 31, 2023—whichever comes first. Assuming the pause is not extended again, tens of millions of borrowers will begin paying their student loans again for the first time three years. In the interim period, millions have changed servicers as a result of servicers leaving the system. Even issues that affect a small percentage of the borrower population could quickly overwhelm servicers' customer contact centers given the volume of borrowers beginning repayment. Moreover, many borrowers will be in different financial situations than they had been before the pandemic and may not be able to afford their previous payments. A rush of applications for income-driven repayment plans or applications to update income information for existing repayment plans could also overwhelm servicers' ability to respond.

IDR and PSLF Payment Adjustments

In October 2021, ED announced multiple temporary changes to the PSLF program, including a series of waivers of prior rules as well as the opportunity for temporary PSLF application. The proposal was designed to alleviate confusion and challenges for borrowers who had trouble claiming credit toward student loan forgiveness because of difficulty understanding the rules. Borrowers not already qualified for PSLF had the opportunity to consolidate their loans into the program prior to October 31, 2022, and ED began processing the waivers. The process has been complicated by the original PSLF servicer PHEAA leaving the student loan program and transferring PSLF servicing to MOHELA over the summer of 2022. Servicers reported being overwhelmed with calls asking about how to apply for temporary relief near the October deadline. MOHELA in particular has reported significant delays in setting up the PSLF processing infrastructure and responding to borrower questions. In addition to the PSLF waiver, ED announced a number of one-time adjustments to IDR payments, mainly giving borrowers additional credit toward loan forgiveness they had not received because of prior servicer mistakes or program complexity. ED plans to continue implementing both PSLF and IDR changes through the summer of 2023.

Regulatory Changes

ED has also made multiple regulatory announcements in 2023 with implications for student loan servicing. After a negotiated rulemaking process in 2021–2022, it released a new proposed income-based repayment plan in January 2023 with much more generous payment terms, interest accrual, and forgiveness provisions than existing plans. The rule would also phase out some older existing IDR plans within limitations set by Congress and encourage borrowers to transfer to the new, more generous plan. Assuming ED finalizes the regulation without substantial changes, it may increase demands on the servicing system as servicers implement another plan and borrowers seeks out more information. However, to the extent the regulations streamline IDR plans, the new rules could simplify some aspects of student loan repayment for borrowers in the future.

ED also announced its intent in January 2023 to hold a new negotiated rulemaking process that would implicate multiple parts of the federal student loan servicing system. ED seeks to adjust regulations for student loan deferment and forbearance that could change standards for when and how borrowers enter and exit these statuses. ED also intends to adjust regulations for third-party servicers, which mainly implicates companies that help higher education institutions manage their federal student aid systems, but could also impact some servicers of FFEL loans.

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