Congress of the United States
Washington, DC 20515

July 7, 2008

The Honorable Gene L. Dodaro
Acting Comptroller General of the United States
U.S. Government Accountability Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. Dodaro:

In recent months, federal student loan programs have undergone a transformation that will impact how millions of American families get the funds they need to attend the college or university of their choice. Since January 1, 2008, the combination of drastic cuts made by the College Cost Reduction and Access Act of 2007 (P.L. 110-84) and unprecedented contraction in global capital markets have forced many major lenders to stop offering federal student loans. The situation for federal consolidation loans is particularly troubling, as lenders representing more than 90 percent of the $47 billion in consolidation loans made last year have ceased to participate in the consolidation loan program since legislative cuts made the program uneconomic. We are concerned about the capacity and viability of the loan programs and efforts to ensure they are available for students and parents.

To try and prevent students from being harmed by the effects of these legislative cuts to the program and the capital market crisis, Congress gave the U.S. Department of Education (the Department) broad authority to help stabilize the loan program through the Ensuring Continued Access to Student Loans Act of 2008 (P.L. 110-227). Even with this new authority, several large lenders have announced their intention to further scale back student loan originations this year. It is clear that borrowers and schools will have fewer options within the Federal Family Education Loan Program (FFELP) and may have to turn elsewhere for access to student loans. Consequently, the Department is beginning to assume a greatly expanded operational role that may grow even further over time.

One of the options being used and that some others are promoting is the expanded use of the William D. Ford Direct Loan Program (Direct Loan or DL). In each of our states, we have schools and students that use the DL program, and have had several schools recently switch into this program because of uncertainty about the stability of the FFELP. We want to ensure that all students and schools served by DL will not suffer reduced service or delays and that the financial integrity of DL—through default aversion and management—does not further erode as significant and unplanned volume shifts into the program.

Based on a review of documents we recently obtained from the Department, we are deeply concerned about the capacity and preparedness of the DL program, the Department, and its contractor, ACS. In light of these concerns and the rapidly changing situation, we are writing to seek your expeditious review of the Direct Loan program and to encourage you to report your findings by July 18, 2008, so that Congress has the information it needs to protect students, schools, and taxpayers.

As noted above, upon inquiry the Department recently shared documents that describe many of the terms, conditions, and modifications for the contract (ED-04-CO-004) which the Department refers to as the Common Services for Borrowers (CSB). By awarding a $2.3 billion CSB contract to ACS, the Department's stated goal was to improve service, reduce costs, increase accountability, and strengthen program integrity by consolidating five separate legacy systems and operations into one unified system. Direct Loan servicing, Direct Loan consolidation processing, and post-default collection activities are part of that system. Modification #40 to that contract, dated May 29, 2007, shows that the Department's contractor failed to deliver these contractual upgrades to the DL systems. A failure of this magnitude suggests that the DL program may not be ready to meet the needs of the potential millions of new college students who will need loans. Equally troubling is that in order for the Department and the taxpayer to ever get back even the small $92 million settlement that was negotiated with ACS as a penalty for failing to deliver a major portion of the $2.3 billion contract, it appears that the Department will have to extend the failed vendor's contract for up to five more years, thereby spending more taxpayer money on a contract that has already failed significantly.

In a Dear Colleague Letter dated May 21, 2008, Secretary Spellings stated that the Department has "the capacity to double Direct Loan origination volume ($15 billion to $30 billion)" and goes on to add that "[a]s a further precautionary measure, we are addressing the hardware, software, and human resource constraints to further increase our ability to originate and service Direct Loans." The last time the Department faced a dramatic increase in loan volume was in 1997 when the Department received twice as many loan applications for consolidation loans as it had projected, and the DL program collapsed. Congress was forced to enact emergency legislation authorizing private lenders to handle the volume so students would not be harmed by DL's failure. This year—given the Department's own projections of consolidation loans made by lenders who can no longer make these loans—even if the Department doubles its capacity to make consolidation loans without collapsing, there still could be as much as a $30 billion shortfall for borrowers. And this still does not address our concerns about the Department's capacity to handle millions of students and billions in loans for schools and students transitioning to DL that the Department may need to handle. History, coupled with the DL's system improvement failures under normal and declining volume conditions over the past several years, cause us great concern, since the Department has not shared any details outlining its plans to double DL capacity and address its known hardware, software, and human resources constraints.

This fall, more students will enter college than ever before in our nation's history. The majority of these students will depend upon federal student loans during their postsecondary education in order to meet the ever-rising cost of college. In order to assess the preparedness and ability of the DL program, the Department, and its contractor to take on millions of new borrowers and tens of billions of dollars in new loan volume, we urge you to answer the following questions and provide your findings by July 18, 2008:

1. What methodology and assumptions did the Department use to determine that it could double DL capacity? Does GAO, based on its own review and knowledge of the Department's

systems and internal controls, conclude that the appropriate methodologies and assumptions were used? Does GAO agree with the conclusions of that review?

2. If the DL program is forced to double its volume, what additional administrative funds and employees would be required? What specific changes are being made to address hardware, software, and human resource constraints? What are the costs associated with those changes? How would the Department pay for those costs?

3. What contingency plans are in place to manage demand if school demand exceeds the doubling of DL capacity and/or the capacity of the existing contractor to service the volume? Are the Department's contingency plans sufficient? Given the current contractor's failure to deliver major systems improvements that were promised, what is the level of risk the Department faces in relying solely on one contractor to handle large increases in volume?

4. What amount of federal consolidation loan volume is the Department preparing for?

5. In the past the Department has argued that its borrower benefits (i.e., discounts) would be cost-neutral to the taxpayer as required by law. By what analysis has the Department shown these arguments to be correct historically, and are they correct today based on the performance of the DL portfolio and under the budget-scoring framework used by the Office of Management and Budget? What percentage of DL borrowers retain the repayment interest rate reduction benefit over the life of their loan? Has the Department estimated the increased cost of extending existing DL borrower benefits to millions more borrowers and what measures are being taken to ensure that benefits are always cost-neutral to the government as required by law?

6. Would a significant increase in loan volume require the Department to extend or renegotiate the terms of its existing contract with its contractor? If the Department's contractor is required to do additional work outside the scope of the original contract due to increased loan volume flowing into the DL program, how much money will the Department be required to pay to the contractor?

Thank you for your attention to this matter of vital interest to millions of college students and their families.

Sincerely,

Pete Hoekstra
Member of Congress

Mark Souder
Member of Congress