



# 5 Facts About the Proposed Student Loan Repayment System

By Colleen Campbell | April 10, 2018

Student loan borrowers may be in for a big surprise in 2019. The U.S. Department of Education's Office of Federal Student Aid (FSA) is proposing big changes to the system that allows more than 37 million borrowers to repay their debt.<sup>1</sup>

After almost a year of revisions and speculation, FSA clarified its vision for a new student loan servicing system in a request for proposals from interested contractors.<sup>2</sup> These vendors must submit bids by the end of April and—from that pool—FSA will select finalists and define more nuanced aspects of the system, to be further defined in Phase II of the solicitation. The new system, which is called the Next Generation Financial Services Environment (NextGen), will go into effect in 2019 and inevitably dictate how borrowers repay their loans for decades to come.

NextGen is a proposed system that should make repayment much more straightforward for borrowers. The plan calls for a single U.S. Department of Education-branded website where borrowers can manage their accounts; a system that allows multiple servicers to work accounts; and upgrades to FSA's technology and data systems.

All these features could improve the quality and consistency of loan servicing, thus reducing delinquency and default rates. The current system is fragmented, with borrowers repaying their loans to one of nine different private contractors, all of whom run their own websites; these servicers also use a handful of different technology platforms.<sup>3</sup> With one system, website, phone number, and mailing address, it will be much easier for borrowers to figure out where to make federal student loan payments.

Missing from the plan, though, is accountability. Part of FSA's role is making sure that its contractors perform their jobs well—and that they experience appropriate consequences if they do not. Congress recently mandated that FSA include some elements to protect borrowers' interests, such as ensuring vulnerable borrowers receive more support from servicers, but time will tell how FSA will respond.<sup>4</sup> The next phase of the solicitation will likely happen in the fall, so there is still time for borrowers to voice their preferences for the new servicing system to the Department of Education and their members of Congress.

This issue brief considers five points of the NextGen proposal, focusing on areas where borrowers should pay particular attention as FSA moves forward.

## Brief history of the NextGen solicitation

In 2014, the Department of Education undertook planning for a new servicing system to replace the current model.<sup>5</sup> Over the next two years, it gathered feedback from financial aid professionals and experts, industry, borrowers, and other stakeholders to inform the principles and structure of the new system. In 2016, FSA released its solicitation and the Department of Education further elaborated on its goals in a policy memorandum.<sup>6</sup> Three contractors were selected to move forward into the second phase of the project, and the solicitation continued to proceed as planned.<sup>7</sup>

Just three months after Secretary of Education Betsy DeVos was confirmed, however, FSA significantly amended the Obama-era solicitation.<sup>8</sup> It removed several customer service features for borrowers and cut back on services for vulnerable borrowers—features that were intended to increase automation and reduce delinquency rates.<sup>9</sup> The amendment also made it possible for FSA to select only one loan servicer. This detail caused significant ire, as FSA tried and failed with a single servicer model in the past, which has contributed to broad bipartisan support for multiple servicers.<sup>10</sup>

Shortly after the solicitation was amended, the chief operating officer of FSA, Jim Runcie, stepped down from his position, citing difficulties working with Secretary DeVos.<sup>11</sup> He was replaced later that summer by Dr. A. Wayne Johnson.<sup>12</sup> The Obama-era solicitation—including its amendments—was pulled, and FSA stated its desire to reconsider the full original solicitation.<sup>13</sup>

After describing preliminary plans in November, FSA released a request for market research on a new servicing system.<sup>14</sup> The full solicitation for NextGen was published in February.<sup>15</sup> One month after it was released, Congress passed the budget omnibus, which requires the system to include multiple loan servicers that compete for accounts based on their performance.<sup>16</sup>

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## 1. NextGen looks similar to the Obama administration's servicing plan

NextGen shares many of the technical elements of the Obama administration's plan. Instead of working directly with 1 of 9 servicers, for example, borrowers would manage their accounts through one federal platform. There, they would be able to make payments, change repayment plans, request postponements, consolidate their loans, get answers to basic questions, and even chat with customer service agents. This would make it easier for borrowers to navigate the complicated process of loan repayment, as they would have one place where they could find information and manage everything related to their federal loans.

Loan servicers and other contractors would plug into a new, centralized technology infrastructure that stores all borrower information, consolidates data systems, and allows for FSA to easily obtain analytics. Yet while this planned back-end would create efficiencies in the long term, it does introduce some complexity that FSA will have to manage carefully. Because several contractors are building these systems, they will have to work together seamlessly, a significant endeavor considering that millions of records are being loaded into the system on a daily basis.

The behind-the-scenes workings of the system are complex, but theoretically, they should result in more consistent service for borrowers and better data available to FSA. With all loan data, borrower accounts, and servicer actions at its fingertips, FSA will be able to monitor its contractors and analyze the repayment system at a level that is not possible now. This could ultimately help prevent delinquency and default.

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## 2. It's unclear how NextGen will hold contractors accountable for their performance

While clearly stated as an element of the Obama plan, accountability is missing from the NextGen proposal. Accountability is crucial, however, as there are a lot of problems in the current repayment system, ranging from poor transparency to a lack of student-focused standards.<sup>17</sup> Servicers who have broken the law or performed poorly have not been fired, and historically, FSA has been slow to address issues with contractors.<sup>18</sup> Furthermore, the NextGen solicitation does not address performance standards or how contractors will be paid, held accountable, or renewed.

Currently, servicers are evaluated across several performance metrics, including customer satisfaction and the share of borrowers whose accounts are current.<sup>19</sup> Good performance on these measures means that contractors are allocated more accounts, allowing them to earn more money. Many consider this competitive aspect of servicing as the best way to ensure servicers work hard to keep borrowers' accounts in good standing.

NextGen would make a competitive servicing environment more complicated. Although the single portal would make borrower repayment simpler, borrowers would not know who their servicer is, meaning FSA would have to monitor and track complaints. While the solicitation does propose more standardized servicing practices—which should improve the consistency of borrowers’ experiences—it will be necessary to balance appropriate baseline standards while at the same time ensuring that servicers still have flexibility to achieve better outcomes.

In theory, the data analytics capabilities of the new system should allow FSA an unprecedented look at how well each servicer is serving various types of borrowers. By using a single platform, FSA could connect directly with borrowers after they interact with customer service agents, getting real-time feedback on the quality of the counseling they received. Because they would now have access to the servicing software, FSA would also be able to monitor phone calls more easily and ensure that servicers keep accurate records. But getting accountability right requires transparency and proactivity from FSA, qualities with which the office has struggled in the past.<sup>20</sup>

It is likely that the second phase of the solicitation will address performance standards and accountability measures, after the finalists to design for each component of the system are chosen. As stated above, the second phase is likely happening in the fall, which means FSA will have some time to come up with the best way to protect borrowers and taxpayer dollars.

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### 3. New players might be entering the federal student loan space

In addition to loan servicing reform, NextGen includes proposals for borrower-facing and back-end technology platforms, a mobile app, data aggregation and analytics, and a cybersecurity system. Although FSA currently operates many technology platforms and data systems, they are fragmented, and almost all of them are managed by different contractors. Most of these contractors have held their contracts for many years. NextGen will bring some of these contractors together and introduce some new ones to the system, requiring a level of coordination that does not currently exist.

The NextGen solicitation states several times that FSA is open to bringing on new contractors without prior experience in federal student loans, signaling that it may be looking to do some house cleaning. While bringing new actors in can help spur fresh thinking and advanced technologies, it can also mean a steep learning curve—one that FSA will have to manage tightly.

It is difficult to say whether FSA has the technical expertise to oversee all these players. In the past, it has faced challenges in supervising its contractors, which has led to borrowers losing millions of dollars.<sup>21</sup> It even has difficulty wrangling its internal units: A supporting document in the solicitation explains that FSA’s web and mobile presences

have been slow to progress due to “a lack of technology know-how (to direct and oversee contractors on change requests)... and a lack of coordination/oversight across various departments (individual departments continue to simply launch their own websites).”<sup>22</sup>

To assist in its oversight efforts, FSA plans to bring on an independent “quality assistance support vendor” that will help staff in “monitoring vendor operations and performance.”<sup>23</sup> But details on this contractor’s role are slim, as it will be hired in a separate solicitation. Hopefully, FSA will call on outside experts and those in other federal agencies—such as the Consumer Financial Protection Bureau, the Treasury Department, and the Federal Trade Commission—to better understand new technologies and learn from past mistakes.

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#### 4. NextGen includes two servicing systems

Because NextGen would host the entire servicing system, it would require technologies built by different vendors to work together seamlessly. This is a daunting prospect considering that the system must track hundreds of billions of pieces of data for more than 170 million loans and 37 million borrowers.<sup>24</sup> Adding to the complexity is the fact that FSA will build two back-end servicing systems, one for older loans and one for new loans.

The system for older loans—Solution 2.0—will include elements of loans and repayment plans that are not offered to new borrowers but that must still be administered for outstanding debt. Solution 3.0—the platform for newer loans—will be more flexible, allowing it to respond to future statutory and regulatory changes. It will also include more efficient mechanisms. But it is unclear how the systems will interact if a borrower has both old and new loans, or whether such borrowers will be transferred from one system to another.

In the past, borrowers have suffered when their loans have been split between different servicers.<sup>25</sup> FSA must ensure that this does not happen in order to prevent unnecessary borrower confusion that could potentially lead to delinquency.

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#### 5. Launching NextGen could be tricky

When FSA transitions to NextGen, it will have to take the data for existing borrowers and load them into the new system. Billions of records—from contact logs to payment history to limited-term postponements—must be imported accurately. These data will not only be imported, they will also be split apart, with payment data living in a component built and managed by one contractor and customer contact information housed in a component built by another. If errors occur during these data transfers, millions of borrowers could experience issues with their accounts that will likely need to be resolved manually—a tedious and costly process.

The last time FSA managed such a significant transfer, some borrowers experienced issues accessing their accounts, payments were lost, and financial aid administrators had little time to prepare.<sup>26</sup> In part, these issues were due to the speed with which the transition had to occur, as well as the lack of diligence put forth by the original servicer in ensuring that borrowers' accounts were properly managed. This time, FSA will have to make sure that all systems are working together seamlessly; monitor transfers to ensure that borrowers experience minimal disruptions; and conduct appropriate outreach to ensure that schools and borrowers know the details of the changes.

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## The future of loan repayment lies in this solicitation

NextGen presents a grand vision, one that would have a significant impact on repayment outcomes. It will determine how borrowers repay their loans for at least the next decade, and any interruptions or errors could cost borrowers significant amounts of money. On the other hand, if FSA pulls off the transition without a hitch and consistently applies solid accountability measures within the system, borrowers will have a much smoother, simpler repayment experience.

Congress will also be watching NextGen closely. It already inserted several requirements for the system in its most recent budget omnibus.<sup>27</sup> These include requiring FSA give NextGen a competitive servicing structure that includes multiple contractors; mandating that vendors have a history of compliance with consumer protection laws; and allowing some borrowers to choose their servicer. This should prove difficult, considering borrowers will not know who their servicer is due to the single Department of Education-branded platform. The omnibus language also mandates a payment structure that would support borrowers who are more likely to have trouble repaying their debt. Going forward, FSA will have to figure out how these elements work within the structure it has outlined.

The stakes are high for FSA and the Department of Education. Under NextGen, borrowers will associate loan servicing with FSA, not a private entity. Poor management could mean further borrower frustration and distrust.

If things go well, however, NextGen could help bolster students' faith in the federal student aid system. It could also mean less stress and more money saved. With an easier repayment process, borrowers would be more likely to pay down their debt faster, have more affordable monthly payments, and avoid collection fees that are levied in default. Ultimately, NextGen could be a win for those trying to get out of debt—but FSA has a lot of work to do to get it right.

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## Endnotes

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