

RECOMMENDATIONS ON BEST PRACTICES IN PERFORMANCE-BASED CONTRACTING

The March 10, 2015 Presidential Memorandum, “A Student Aid Bill of Rights to Help Ensure Affordable Loan Repayment” (Presidential Memorandum), directed an interagency task force (Task Force) consisting of the Department of the Treasury, Department of Education, Office of Management and Budget, and Domestic Policy Council to monitor trends in the student loan portfolio, budget costs, and borrower assistance efforts. In conjunction, the Presidential Memorandum directed the Task Force to review recommendations no later than August 1, 2015 on best practices in performance-based contracting to ensure that contractors providing student loan servicing help borrowers responsibly make monthly payments on their student loans.

To develop these recommendations, the Task Force consulted with the Consumer Financial Protection Bureau (CFPB) as well as numerous experts on performance-based contracting, student lending, and servicing other forms of consumer debt including: (i) federal agencies responsible for contracting, loan-program servicing, and oversight of federal loan programs; (ii) mortgage lenders, servicers, and mortgage industry experts; and (iii) student loan stakeholders such as consumer advocates, student groups, and think tanks. These groups identified best practices and, in many cases, provided recommendations that could be applied to federal direct loan (Direct Loan) servicing contracts.

Based on these discussions and related research regarding contracting and servicing best practices, the Task Force has developed recommendations in five primary areas:

- **Compensation structure:** Use a compensation structure that continues to incentivize contractors to keep all borrowers current and also provides targeted incentives based on the performance of borrowers identified by Federal Student Aid (FSA) as being at a greater risk of default when they separate from school. Evaluate the impact of the targeted incentives on borrower performance to determine whether they should continue through the duration of the contract.
- **Performance measurement and new loan allocation:** Structure the allocation formula to award new loan volume based on a comprehensive set of metrics that measures contractor performance in (i) driving positive borrower performance, (ii) providing quality customer service, and (iii) adhering to contract requirements and maintaining strong business practices and internal controls.
- **Standardized minimum service-level and borrower communication requirements:** Establish a minimum level of required services that include certain standardized communications, a suite of technology-enabled communication, and enhanced, “higher-touch” servicing requirements for borrowers at risk of default, including those identified as being at greater risk of default at school separation and those who become delinquent.
- **Robust borrower protections and complaint resolution processes:** Implement, in conjunction with the development of a centralized complaint system, a standardized complaint process that provides for clear borrower rights, a specific process to address

borrower complaints about interactions with a contractor, and an FSA resource to address escalated complaints.

- **Strong oversight processes and enforcement mechanisms:** Use oversight and auditing of contractors to monitor compliance with contractual requirements and incorporate assessments of compliance into performance metrics. Contractors should be subject to penalties and withheld compensation for noncompliance or other violations of the contract.

The Task Force notes that several other Department of Education initiatives called for by the Presidential Memorandum will complement these recommendations and help to provide borrowers consistent, high-quality servicing from origination through final repayment. These initiatives include the work already underway to develop and implement a simple process for borrowers to file complaints regarding federal financial aid and the establishment of a centralized point of access for all federal student loan borrowers. Other potential structural modifications to the servicing system, in addition to this document's recommendations, could also improve the borrower experience. Requiring student loan servicing contractors to use universal Department of Education branding in all borrower communications could reduce confusion and improve the customer experience. A centralized location branded by the Department of Education that provides borrowers with access to their account information, the ability to make payments, and comprehensive information about federal student loan borrowing and repayment could provide similar customer experience benefits. Requiring servicing contractors to use a single, integrated information system could reduce the burdens associated with coordinating consistent student loan servicing contractor behavior, reduce the challenges of transferring loans between contractors, and provide reporting and system integration benefits to the Department of Education. Finally, the number of future servicing contractors should be sufficient to realize the benefits of robust competition but avoid the programmatic and technological challenges of overseeing a large number of contractors.

The remainder of this document outlines the Task Force's recommendations for best practices in performance-based contracting and how these practices would improve borrower performance and experience.

BACKGROUND

Since 2008, the Obama Administration has increased total aid available to students by over \$50 billion and increased tax benefits and credits by an additional \$12 billion, all part of a total of about \$150 billion in grants and loans each year for higher education. While these efforts have helped mitigate the cost of college for millions of American families, federal student loans remain the largest source of aid from the federal government. Today, the federal government maintains a student loan portfolio of nearly \$1.2 trillion, including \$787 billion in Direct Loans. In contrast to commercial financial products, federal student loans are taxpayer-provided educational benefits designed to promote equal educational opportunities by providing access to higher education. Federal student loans are intended to promote equal educational opportunity and, thereby, help ensure that all Americans can prosper economically and socially. The law

guarantees that Federal student loans are available to all qualified students, without regard to credit profile, at affordable interest rates, and with additional borrower protections and benefits unavailable in the commercial-credit market. Other benefits include periods where no interest is charged for some borrowers and flexible repayment options that provide a safety net for borrowers facing economic uncertainty or hardship. For borrowers pursuing careers in public service, outstanding loan balances remaining after 10 years of repayment can be forgiven. Federal student loans also carry a host of other protections for borrowers, including closed school cancellations and the ability to discharge the loans in cases of permanent disability or death.

Before the move to a 100 percent Direct Loan program, federally-guaranteed student loans were largely originated and serviced by private financial companies. In the wake of the financial crisis, large disruptions to students' access to federal loans under the federally-guaranteed program led Congress to enact legislation and necessitated expedient establishment of new contracts for the Title IV Additional Servicers (TIVAS). The Department of Education awarded these contracts in preparation for the servicing of a then-unknown quantity of Federal Family Educational Loans (FFEL) sold to the government as a result of the Ensuring Continued Access to Student Loans Act (ECASLA). The servicing capacity brought online through these contracts also was subsequently utilized for the shift to an entirely Direct Loan program in the Student Aid and Fiscal Responsibility Act (SAFRA), which provided loans without interruption to millions of students from thousands of institutions. Due to this rapid and significant expansion, the contracts included some flexibility in servicer systems and practices and used contractual incentives, such as per-borrower payment levels and new loan allocation metrics, to drive contractor performance. Eleven other not-for-profit (NFP) servicers, earmarked by Congress to receive loans to service, initially did not have the same pricing and contract structure. Over time, FSA has included additional requirements in the TIVAS contracts and modified the NFP contracting agreements to better align contract incentives with improvements to borrower servicing across both contracts. In 2014, FSA modified the TIVAS contracts to increase incentives to keep borrowers current and to improve the servicing system within the framework and structure of the original 2009 contract.

FSA services the FFEL loans purchased under the ECASLA program and Direct Loan program loans through the use of private contractors. From the passage of SAFRA on July 1, 2010, through December 26, 2013, servicing activities were funded both by discretionary funds and mandatory funds provided by SAFRA for eligible NFP servicers. The Bipartisan Budget Act of 2013 eliminated mandatory funding for NFP servicing costs and now all servicing costs are funded by discretionary budget authority.

In this year's budget, the President requested \$855.2 million for loan servicing.¹ This cost is based on the overall loan volume, repayment composition of the loan portfolio, and the timing of loan delivery. As loan volume grows, the portfolio matures, and more borrowers move from in-school status to repayment, the total cost for servicing is expected to increase. Servicing costs are sensitive to changes in borrower volumes and the distribution of borrowers among repayment

¹ The \$855.2 million request for loan servicing included \$842.8 million for operations and maintenance for student loan servicing contractors; \$11.6 million for system development costs; and \$0.8 million for customer service satisfaction surveys required for allocation of borrower accounts based on performance.

statuses. The recommendations of this Task Force should be considered in the context of a fully funded federal student loan servicing budget request.

The original TIVAS contracts expire in 2019, and FSA's planned acquisition of new servicing arrangements provides an opportunity to incorporate the experience gained over the past six years in federal student loan servicing and the experience of other programs that use performance-based contracting. Based on discussions with a range of experts and student loan stakeholders and our review of other industries, the Task Force developed five areas of potential improvements: (i) compensation structure; (ii) performance measurement and new loan allocation; (iii) effective minimum service-level and borrower communication requirements; (iv) robust borrower protections and complaint resolution processes; and (v) strong oversight processes and enforcement mechanisms. These recommendations strike a balance between strong minimum requirements, flexibility for innovation and competition, and incentives and performance assessment to drive best practices and assist borrowers in becoming and remaining current on their loans.

I. COMPENSATION STRUCTURE

Effective performance-based contracting should align incentives to facilitate specific outcomes based on program objectives and provide sufficient compensation to allow contractors to perform necessary activities. Over the past six years, FSA has refined its contractor compensation structure. In the current pricing structure (after the 2014 modifications), contractors are compensated at a higher monthly rate for borrowers who are current on their loans than for borrowers who are delinquent, in forbearance, or in deferment. This provides incentives for contractors to keep borrowers current. It also avoids a potential unintended consequence of paying contractors more to service delinquent borrowers, which could incent the contractor to allow borrowers to become delinquent to receive higher payments.

As a result, FSA's student loan servicing contractors receive the highest compensation for current borrowers, who may require limited assistance, and lower compensation for delinquent borrowers, who may require an increased level of servicing activity. For any individual borrower, it is possible that the higher payments for periods in which the borrower is current could compensate for the additional servicing activity required during periods of delinquency if the expected lifetime revenue received from assisting such a borrower is greater than the associated expense. Alternatively, the higher payments for the larger population of reliably current borrowers (that can be serviced at lower cost) and the additional volume of future borrowers that can be gained due to low delinquency and default rates (which are metrics used to allocate new loans) may offset the costs that the servicer incurs to service the smaller population of higher-risk borrowers - even if these specific activities are not necessarily profitable on a per-borrower basis. Currently, there is not sufficient data to assess fully either possibility. However, other industries, such as mortgage servicing, have begun to use more targeted structures that both require and incentivize servicers to direct greater resources to vulnerable borrowers to help them successfully enter into a modification and long-term repayment status.

Standard servicing activities such as collecting payments and sending account statements can be done efficiently through low-cost, routine processes and may be sufficient for many borrowers. However, a one-size-fits-all approach is poorly suited for borrowers at higher risk of default. Servicing these borrowers requires a more robust set of procedures, resources and skills, and requires more intensive servicing efforts to establish contact, convey critical and potentially complex information to borrowers regarding their options, and return borrowers to repayment. To address this challenge, the mortgage industry and other sectors of consumer lending have augmented the standard servicing offering with a higher-touch servicing model that targets at-risk borrowers – determined based on delinquency, eligibility for modification or other forms of assistance, or other identified risk factors. In exchange for meeting more demanding servicing requirements for at-risk borrowers in this model, contractors may be compensated at higher levels or receive incentives tied to the borrower’s performance.

Recognizing the important differences between student loans, mortgages, and other forms of consumer lending, a contractor compensation structure that provides differential compensation and incentives based on the expected cost of servicing the borrower may be appropriate. The acquisition of new servicing contractor arrangements is an opportunity to enhance the 2014 incentive improvements by implementing a new compensation model that moves beyond the current one-size-fits-all approach while still rewarding contractors who succeed at driving positive borrower performance.

Recommendation: Use a compensation structure that continues to incentivize contractors to keep all borrowers current and also provides targeted incentives based on the performance of borrowers identified by FSA as being at a greater risk of default when they separate from school. Evaluate the impact of the targeted incentives on borrower performance to determine whether they should continue through the duration of the contract.

FSA should specify a baseline level of services and use a compensation model that incentivizes contractors to keep borrowers current. Per-borrower, monthly payments should decline if the borrower becomes delinquent or is placed in deferment or forbearance, as is the case in the current contracts, to continue to provide incentives for contractors to get and keep all borrowers in current repayment status. In addition, contractors should be required to provide a suite of higher-touch services (see recommended service-level requirements in Section III) for certain borrowers, including borrowers who have demonstrated difficulty making required payments and those identified by FSA as being at greater risk of not successfully entering repayment and remaining current when they leave school (such as those who do not complete a degree).

The compensation structure should include targeted compensation and incentives tied to the performance of the borrowers identified by FSA as being at greater risk of default when they separate from school. Targeting these borrowers early in the repayment process could prevent delinquencies and improve the likelihood that they successfully enter into repayment. The contractor could receive higher initial monthly payments after school separation for this subset of borrowers (e.g., for up to six months) to compensate for the additional initial servicing requirements.² In addition, the contractor could also be eligible to receive bonus payments tied

² Alternatively, the per-borrower, monthly compensation levels a contractor receives for all borrowers could be adjusted based on the proportion of borrowers it is allocated that are at greater risk of default at school separation.

to helping these borrowers successfully maintain current status on their loans. For example, the contractor could receive a bonus once a higher-risk borrower has made six consecutive on-time payments under a qualified repayment plan (not forbearance or deferment). The contractor could also be eligible to receive ongoing annual bonuses for higher-risk borrowers that remain consistently current for a specified period of time (e.g., 5 years).

As noted above, contractors should be required to perform more intensive higher-touch servicing actions as these borrowers initially enter repayment and require additional assistance to select a suitable repayment plan, make on-time payments, and remain current. Higher-touch servicing should also be required for any borrower, whether identified as higher-risk or lower-risk when separating from school, that demonstrates difficulty remaining current after entering repayment (e.g., by becoming delinquent). However, the contractor would not receive the targeted compensation and incentives for provision of higher-touch servicing in these cases as this would potentially lead to perverse incentives by rewarding contractors for poor borrower performance.

To offset the added expense of the targeted compensation and incentives, the baseline per-borrower compensation levels could be reduced because many of the borrowers identified as lower risk at school separation can be serviced at a relatively low marginal cost. The reduction also takes into account that contractors would receive separate, targeted compensation for some borrowers at greater risk of default that are expected to cost more to service. In some cases borrowers identified as lower risk will be expensive to service because, despite lower risk factors, they will not remain current and will require additional servicing. However, borrowers who are not current should receive higher-touch servicing, regardless of whether the individual was identified as higher or lower risk at school separation.

In implementing this recommendation, FSA should test the efficacy of the new compensation structure to determine whether the compensation and incentives tied to borrowers identified as being at greater risk of default at separation from school results in improved borrower performance. After a sufficient period of time, this information should be utilized to determine whether to continue, modify, or terminate the incentive for the duration of the contract.

II. PERFORMANCE MEASUREMENT AND NEW LOAN ALLOCATION

Rigorous performance measurement and the allocation of new business based on relative-performance levels are used by private and public entities for effective performance-based contracting. Measuring performance across several categories and multiple metrics within each category improves the ability to assess contractor performance consistent with contract objectives and requirements. In addition, the selection of the metrics and their relative weights should be based on a quantitative assessment of the metrics' reflection of the contractor's effectiveness in helping borrowers to make on-time payments.

Allocation metrics are likely to influence where contractors choose to direct their resources. The current TIVAS allocation formula uses the contractors' relative performance across five weighted factors measured on a quarterly basis, and averaged across the year, to determine the percentage of new loan volume each contractor will be allocated in the next year. In particular,

the current allocation formula relies heavily on borrower delinquency rates and the borrower survey.³ These metrics are certainly indicative of some elements of borrower performance and satisfaction. However, broader assessments and more granular metrics may more accurately measure the effectiveness of contractors at maximizing sustainable repayment for borrowers. Including additional metrics may also incent contractors to focus resources on the areas evaluated such as borrower protections, adherence to program requirements, and strong business practices that increase the consistency of borrowers' experiences. Measuring performance across these categories could align contractors' incentives, FSA program goals, and positive borrower performance, such as making on-time payments, avoiding delinquency and default, recertifying for income-driven repayment (IDR) plans, and understanding loan and repayment plan terms and conditions.

Recommendation: Structure the allocation formula to include a comprehensive set of metrics indicative of contractor performance in (i) driving desired borrower performance, (ii) providing quality customer service, and (iii) adhering to contract requirements and maintaining strong business practices and internal controls. Publish detailed quarterly summary of contractor performance on these and other metrics to increase transparency and competition between contractors.

Metrics used to assess contractors and allocate new loans should clearly align with FSA goals for the borrower experience and performance. Contractors will seek to maximize their results within the chosen metrics, so incomplete or imprecise metrics risk diminished and perverse outcomes.

To measure contractor performance in driving sustainable borrower repayment, there are additional metrics that could be added to the current delinquency and default metrics. Examples include rates of transition between delinquency states (roll rates), the percentage of borrowers in forbearance, and, for borrowers identified as being at greater risk of default when they separate from school, the percentage that enter into and remain in current status. FSA could also consider incorporating a metric to incentivize contractors to assist borrowers in completing on-time annual recertification for IDR plans,⁴ such as the rate at which borrowers in IDR plans become delinquent or enter deferment or forbearance because they do not complete timely recertification.⁵ The metrics and weightings should be determined based on FSA's analysis of metrics that are most predictive in explaining contractor performance in assisting borrowers to remain in current status.⁶ In addition, allocation metrics should be adjusted to control for key

³ The current allocation formula is: (i) 30 percent: percentage of borrowers in current repayment status (not more than 5 days delinquent); (ii) 15 percent: percentage of borrowers more than 90 but less than 271 days delinquent; 15 percent: percentage of defaulted borrowers (over 270 days and less than 361 days delinquent); 35 percent: borrower survey results; and 5 percent: FSA employee survey results.

⁴ Borrowers are required to recertify for IDR every year, including submitting proof of income to determine any changes in required monthly payments, or the payment amount will revert to the amount that would have paid under a standard 10-year repayment plan. In addition, if the borrower does not recertify on time the interest may capitalize.

⁵ FSA would need to determine how to appropriately define any measure tied to IDR recertification, as not all borrowers in IDR plans will remain eligible for a partial financial hardship or choose to recertify. An imprecise metric could potentially incentivize perverse outcomes, such as contractors attempting to steer borrowers to specific repayment plans that may not be in the borrower's best interest.

⁶ As an example of the importance of identifying predictive metrics, some student loan stakeholders suggested that the current allocation metrics may motivate servicing contractors to spend unnecessary resources on borrowers 1 to

differences between contractor portfolios so that a contractor's allocation from prior years and overall borrower mix do not unduly influence future allocations. To allow FSA to improve the allocation metrics over time, the contract should incorporate flexibility to make changes to the metrics or weightings. As the student loan program further develops, economic conditions change, and contractor performance evolves, new metrics could be incorporated based on FSA data analysis to further align goals between borrowers, contractors, and FSA.

To incent effective customer service and borrower protections, additional measures beyond the borrower survey should be incorporated. The current borrower survey is a broad measure of overall borrower satisfaction with their contractor. However, adding new borrower experience metrics and improving the survey instrument will provide a more robust and reliable measure of a contractor's customer service performance. A good consumer experience includes providing essential and accurate information to all borrowers in a concise and actionable way, assisting borrowers in determining their optimal repayment plan and successfully managing their loans, and meaningfully and accurately responding to borrower disputes. For example, this could be measured through metrics such as the borrower wait time when calling their contractor or contractor response time for web-based inquires. A formal complaint review process (discussed in Section IV) may allow for additional metrics such as the number of escalated complaints against a contractor or how quickly the contractor responded to the borrower's complaint.

In addition, the borrower survey should be expanded to assess how well contractors are performing core functions necessary for borrowers to make informed decisions about their repayment options, such as informing borrowers about IDR plans, the terms of their loan(s), and dispute resolution mechanisms. The survey components could be also used to produce index scores for each contractor to be included in the allocation metrics (in addition to the general American Customer Satisfaction Index (ACSI) score) to improve competition between contractors on the specific subjects of the survey.

The performance and allocation metrics also could incorporate FSA's assessments of the contractors' conformance with the servicing requirements, business processes, and internal controls. Including the results of the audit and compliance review processes in the allocation score would reward contractors that conform to baseline servicing requirements and impose costs on those that are unable to meet these requirements (see Section V for additional detail on the monitoring and audit processes and potential metrics).

Finally, these metrics should be published regularly with more detailed assessments and measures of performance, including detailed results of the borrower survey. A number of groups consulted by the Task Force noted the benefits of transparency and applying public and competitive pressures to contractors through public performance assessments.

5 days delinquent who would otherwise self-cure. The current allocation metric considers a loan to be current if the payment is less than 6 days delinquent. Based on this cut-off, servicing contractors spend significant resources contacting and assisting borrowers who are 1 to 5 days delinquent on their loan, but the delinquency may be due to the borrower's income regularly becoming available after their loan payment date.

III. STANDARDIZED MINIMUM SERVICE-LEVEL AND BORROWER COMMUNICATION REQUIREMENTS PAIRED WITH FLEXIBILITY FOR INNOVATION

Strategies for when and how to interact and communicate with customers can be an area of competition and innovation within a performance-based contract. However, many contracts also include specific, baseline requirements so that consistent, high-quality service is maintained by all contractors and that essential information is conveyed. For federal student loans, FSA requires contractors to notify borrowers of their account status and options for repayment. The requirements include timelines and basic information that must be communicated to delinquent borrowers.⁷

Recently, the best practices in other industries, including mortgage servicing, have moved towards more prescriptive baseline requirements. Mortgage servicing requirements, for example, have evolved to include specifications regarding accuracy of information provided to borrowers, adherence to program requirements for communications, adequate service in providing information through a borrower portal, appropriate responsiveness to borrower inquiries, and training requirements for contractor staff. As borrowers become delinquent, requirements increase and the contracts specify how servicing requirements must change, such as providing a single point of contact for certain borrowers.

In our research, early, clear, and consistent communication materials were regularly cited as a best practice for servicing and preventing delinquency and default. By setting more specific requirements for contractors, FSA can maintain a consistent baseline level of service, improve overall borrower communication, and, through robust monitoring and the allocation metrics, incent contractors to uniformly comply with these minimum requirements.

Recommendation: Establish a strong, baseline level of required service including: (i) certain standardized communications to borrowers with specific, quantifiable requirements, (ii) a required suite of technology-enabled communication for borrowers, and (iii) enhanced servicing requirements for borrowers at risk of default including those identified as being at greater risk of default at school separation and those who become delinquent.

As part of specific, baseline service requirements, FSA should promote more effective, standardized communication. In particular, FSA should establish a core set of clear, easy-to-read tables that contain consolidated loan information that is most valuable for the borrower to make informed decisions. FSA could consider best practices in consumer disclosure developed by other federal resources as needed. FSA should require contractors to display these tables prominently in standard communications with borrowers, with minimal exceptions.

This requirement, similar to a requirement for credit card statements, would vary slightly based on the status of the loan, number of loans serviced, or selected repayment plan, but could include: loan balance, monthly payment, interest rate, next payment date, final payment date, and, where applicable, availability of IDR repayment options including estimated repayment

⁷ These requirements are outlined in the FFEL program regulations. The TIVAS contracts require compliance with these requirements for servicing Direct Loan borrowers.

amounts and estimated length of repayment at different income levels. For borrowers in IDR plans, it could also include the IDR recertification window and deadline, the new payment amount if the borrower fails to recertify their income on time (if applicable), and the amount of accrued interest that would be added to the principal balance if they fail to recertify. In any telephone communication with borrowers in delinquency, forbearance, or deferment, contractors could also be required to convey specific information on IDR options based on the borrower's loan balance and any additional information provided by the borrower.⁸ In addition, contractors could be required to contact borrowers at certain key times, such as 60 and 90 days prior to an anticipated change in repayment amount or while they are still enrolled in school or in grace. Borrowers nearing the end of their time in school, forbearance, or deferment or nearing the IDR income recertification deadline could also receive specialized communications.

Successful repayment and overall borrower performance also depend, in part, on the quality and availability of modern, easy-to-use methods of interacting with contractors. Best practices across various industries suggest that contractors should be required to provide a baseline set of tools for borrower communication. Online chat and direct email have proven successful in other fields, particularly with younger or delinquent borrowers. Direct email communication would allow borrowers to both read and respond to account notifications through their inbox (rather than being directed to the contractor's website to access a message only viewable after logging in) and interact with representatives. Where permissible, text message notifications of important deadlines for payment or IDR recertification, as some servicers already employ, will 'nudge' borrowers who fail to check their account statements or miss other communication from contractors.⁹ Digital document upload (similar to remote check deposit) has been successfully deployed to ease the paperwork burden on borrowers in other contexts and should be available for all borrowers to submit required documentation for programs like Public Service Loan Forgiveness (PSLF), IDR, or Total and Permanent Disability (TPD). Contractors also could be required to develop clear and intuitive tools and visualizations to assist borrowers in understanding how repayment options will impact their loan balance and tracking successful payments made toward forgiveness. Mobile points of access (as some servicers currently use) or apps should be available to make the repayment process as convenient as possible. It should be noted that these communications will need to maintain protections of private borrower information and in some cases may be restricted by regulatory or other requirements.

For borrowers at greater risk of default, including both those identified at separation from school and those that become delinquent while in repayment, more intensive, higher-touch servicing requirements are needed so that these borrowers receive sufficient assistance. Many of the experts we spoke with referenced the benefits of establishing a single point of contact in mortgage servicing to assist borrowers. The single-point-of-contact model allows servicing representatives to have a detailed understanding of each individual borrower's file and account,

⁸ For example, the contractor could state "based on your debt with us, if your income is under \$xx,xxx you may qualify for a lower monthly payment." The contractor could also provide, if the borrower provides sufficient information, an estimate of monthly repayment under IDR and the amount of interest that would accrue during repayment.

⁹ Currently, text messages are considered 'calls' under the Telephone Consumer Protection Act (TCPA) – limiting contractors' ability to employ this technique for all borrowers. The Administration has sought to amend the TCPA to allow auto-dialing on cell phones for the purposes of delinquent federal debt collection and to improve the ability of contractors to reach borrowers.

required documentation, and stage in the modification process. At the same time, the paperwork burden and time involved in modification is considerably greater in the mortgage industry. In federal student loan servicing, the loans, the borrower protections, and repayment options are relatively standardized, so a true “single” point of contact may not be necessary. Instead, higher-touch servicing could require the contractor to assign small servicing teams with easy to reach, live phone representatives to each borrower at risk of default.

These contact teams would be responsible for being knowledgeable about their assigned borrowers’ situations and current status, communicating the options and next steps for the borrower to enter into a sustainable repayment plan, and coordinating and tracking any necessary documents (e.g., IDR certification). Each contractor should be required to develop and implement a policy that identifies experience and training requirements for these specialized teams and the appropriate caseload levels so that they can successfully fulfill the requirements. FSA should assess whether these policies are sufficient and, through its oversight of contractors, monitor the effectiveness of training modules and that borrowers can speak to senior representatives when needed.

Recommendation: Allow contractors to apply for waivers of certain requirements on a subset of their borrowers to test innovative strategies that improve borrower outcomes.

While minimum requirements can help to establish consistent and effective service, it is also not desirable to stifle contractors’ ability to develop and test new servicing strategies. While the above requirements would not restrict contractors from developing innovative communications, FSA may want to waive certain requirements to test new strategies (as permitted by the terms of the contract and applicable principles of procurement law). Under this waiver system, contractors could propose to FSA that certain requirements be waived in favor of a specific alternative plan. All proposals should include specific target outcomes, identify implementation risks, and detail how the proposal would advance FSA program goals. All loans included in the waiver should be excluded from the allocation metric as to avoid penalizing contractors’ future business if the proposal is not successful.

IV. ROBUST BORROWER PROTECTIONS AND COMPLAINT RESOLUTION PROCESS

A mechanism to highlight and resolve borrower complaints can improve customer service while also imposing additional discipline on the contractor. As highlighted in the Presidential Memorandum, FSA is developing an enhanced complaint system. While contractors servicing federal student loans currently are required to have a complaint resolution process, this process does not appear to be standardized and has only a limited role for FSA. In addition, borrower complaints and contractor performance in resolving complaints do not factor into the allocation metrics or contractor compensation. A standardized complaint process could be a valuable component of the overall allocation metric and strategy to improve contractor performance and customer service. This would allow FSA to identify timeliness of response and borrower satisfaction with the resolution to the dispute, publicly release complaint data, and hold

contractors accountable. Incorporating these features could improve the allocation system by placing a direct incentive to provide remedies that work well for borrowers.

Recommendation: Implement, in conjunction with the development of a centralized complaint system pursuant to the Presidential Memorandum, a standardized complaint process that provides for (i) clear borrower rights, (ii) a specified process to address borrower complaints about interactions with a contractor, and (iii) a formal escalation process with an FSA resource to address escalated complaints.

First, the contract should enumerate clear obligations the contractor has to the borrower. This could include, among other obligations: (i) providing full and accurate payment and balance information; (ii) accurately reporting to the credit bureaus, National Student Loan Data System for Students (NSLDS), and others; (iii) sending required notifications to the borrower's most up to date contact information on file; (iv) informing the borrower of all options and repayment plans available to them, including PSLF and TPD; (v) providing status updates for IDR, TPD, or PSLF applications; and (vi) providing clear documentation of all qualified payments made toward loan forgiveness. While contractors are already subject to some of these obligations through existing regulation or current contracts, enumerating and expanding these requirements in the contract may provide additional clarity. In addition, communicating these contractor obligations to borrowers may help borrowers to understand expected service levels and to assess whether they have been treated fairly and whether to pursue a dispute with the contractor.

Second, the contractor should be required to have a clear complaint and resolution process, including a timeline for addressing the complaint and specified personnel responsible for responding to complaints. This process would include allowing borrowers to request a 'second look' by a senior employee or manager at any point in time to determine whether the borrower's situation was handled in accordance with all relevant statutory, regulatory, and contractual procedures including the contractor obligations outlined above. The contractor should also be required to disclose to borrowers that, if they choose, they can also direct their complaint to the Department of Education, currently through FSA's Student Loan Ombudsman and in the future through the central complaint system being developed pursuant to the Presidential Memorandum. Finally, borrowers should be able to monitor the status of their complaint through the customer portal.

Third, the contract should prescribe a formal escalation and resolution mechanism for certain borrower complaints in which a dedicated complaint resource (this could be FSA's Ombudsman, an alternative FSA resource, or a delegated third party if preferable) would work with the contractor to provide appropriate resolution of the dispute. The Ombudsman's office currently handles some student loan disputes. However, to integrate that work into the contract process, that office (or another within FSA) would have to take on the additional responsibility of deciding disputes rather than mediating them. The FSA complaint resource would evaluate the circumstances and status of a borrower's complaint and work with the contractor to resolve the complaint consistent with the contract requirements.

The contract should specify under what conditions complaints must be escalated (e.g., certain types of complaints or complaints that are not resolved internally by the contractor within a

specified timeframe) and maximum timeframes for the contractor to respond. Once a complaint is formally filed, contractors should be required to acknowledge and respond within a specified timeframe, outline any additional actions and a timeline for addressing the complaint, and if appropriate, escalate the complaint to the complaint resource with documentation in a timely fashion. If, at the end of the process, the FSA complaint resource determines that the contractor violated a statutory, regulatory, or contractual provision, the contractor could be required to provide appropriate remedies. The contracts should also include robust reporting requirements on the number and nature of complaints received and addressed. FSA also could consider whether to require contractors to direct escalated complaints to consumer protection agencies, such as the CFPB, or provide additional disclosure about other complaint resolution mechanisms where appropriate.¹⁰

As discussed in Section II, a contractor's performance on handling complaints could also be incorporated into the performance reports and allocation metrics. This could include complaints that are escalated to the FSA resource (i.e., ranking contractors based on the ratio of escalated complaints to the total borrower population). Additional measures of contractor performance with regard to complaints, such as the percentage of complaints a contractor responded to in a timely manner and adherence to other complaint process requirements, could be incorporated. Even if there is not wide variation between contractors along these metrics, directly incorporating this requirement into the allocation metric and highlighting it in the public performance reports will further motivate contractors to be responsive to borrower concerns.

V. STRONG OVERSIGHT PROCESSES AND ENFORCEMENT MECHANISMS

Targeted compensation and performance measurement to align contractor incentives, standardized baseline service requirements, and robust borrower protections and complaint resolution are important tools for producing positive performance. However, these tools should be complemented with the proper monitoring of contractor performance, including auditing and compliance-review processes, to confirm that contractors are meeting the baseline requirements of the contract and providing necessary customer service. Oversight and auditing also can be used to assess whether the incentives are working as intended or whether they are leading to unintended consequences.

Where required services are not being appropriately provided, the contract should include enforcement tools and appropriate administrative and contractual remedies to be imposed on contractors that fail to comply with the requirements of the contract. Such tools and remedies may include withholding of compensation, reduced amounts of new loan allocations, loss of bonus funds, and where appropriate penalties or sanctions including liquidated damages. During our review of other industries, some groups noted that a contractor's failure to meet its requirements can result in corrective action plans, sanctions, penalties, or the removal of loans being serviced, in part or in full, from the contractor.

¹⁰ The CFPB currently accepts complaints from consumers with federal student loans related to debt collection. In 2011, FSA signed a memorandum of understanding (MOU) with CFPB to govern referral and information sharing related to consumer complaints between the agencies.

Recommendation: Use oversight and auditing of contractors to monitor compliance with contractual requirements and incorporate assessments of compliance into performance metrics. Contractors should be subject to administrative and contractual remedies, including withholding of payment and where appropriate, penalties and sanctions for noncompliance or other violations of the contract.

FSA's oversight, audit, and compliance review functions should seek to ensure that all contractors are meeting the contractual requirements. FSA already conducts a number of monitoring and review functions, including on-site audits, reviews of selected loan files, and reviews of calls with borrowers. Continuation and enhancement of these efforts could be used to assess contractor compliance with the above requirements and others such as timeliness of borrower communications and accuracy of payment allocation across loans or in the case of over/under payment.

As discussed in Section II, contractors should be incentivized to adhere to contract requirements by including in the allocation metrics and performance reviews measures of their audit and compliance review scores, conformance with contractual requirements, and sound operational practices. FSA should identify key metrics to include in the allocation metrics to reward contractors who most closely follow legislative, regulatory, and contractual requirements. For example, the metric could include results from FSA's audits of phone calls for conformity with contractor scripts, accuracy of representatives' statements, and proper escalation of complaints.

The contracts also should include provisions for administrative and contractual remedies, including, where appropriate, assessment of financial penalties and the ability to withhold future payments if a contractor fails to meet the requirements. When contractors violate consumer protection laws, there should be a mechanism to share this information with the CFPB. In 2014, the CFPB launched an examination program covering nonbank student loan servicers, extending its supervisory authority to potentially include periodic examinations of FSA's contracted student loan servicers. FSA and CFPB signed a memorandum of understanding (MOU) to govern the sharing of information about the performance of and examination results related to the conduct of FSA's student loan servicing contractors. In addition, FSA should use the monitoring and audit processes to assess the effectiveness of contractual incentives and that contractors are not acting against the spirit of the contract or the interests of borrowers to increase compensation.