December 15, 2011

MEMORANDUM

TO: James Runcie
Chief Operating Officer
Federal Student Aid

FROM: Keith West /s/
Assistant Inspector General for Audit

SUBJECT: FINAL CONSULTING REPORT
Title IV Additional Servicers Capacity Assessment
ED-OIG/S15L0001

Attached is the subject final consulting report prepared by Ernst & Young, LLP, as a result of its assessment of the current status of the Title IV Additional Servicers (TIVAS) to handle the volume of servicing new Direct Loan Program originations and consolidations and the servicing of Federal Family Education Loan Program loan purchases under the Ensuring Continued Access to Student Loans Act of 2008. The assessment was performed on our behalf by Ernst & Young, LLP, under the American Institute of Certified Public Accountants' Consulting Standards. The scope of the assessment was established in a Statement of Work agreed to by the Office of Inspector General and Ernst & Young, LLP. The report's Executive Summary contains an overview of the assessment's scope and procedures performed by Ernst & Young, LLP.

The report is intended solely for the information and use of the Office of Inspector General and management of the Department. It is not intended and should not be used by anyone other than these specified parties. In accordance with the Freedom of Information Act (5 U.S.C. § 522), reports issued by the Office of Inspector General are available to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act.

We appreciate the cooperation given Ernst & Young, LLP, during this assessment. If you have any questions, please contact Patrick Howard, Deputy Assistant Inspector General for Audit, at (202) 245-6949 or Kenneth Smith, Director, Student Financial Assistance Advisory and Assistance Team, at (202) 245-6968.

Attachments

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U.S. Department of Education

TIVAS servicing capacity assessment

May 2011

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May 16, 2011

To the Office of Inspector General and Management of the U.S. Department of Education:

We have completed our engagement to assess the current status of the Title IV Additional Servicers to handle the volume of servicing for all new Direct Loan originations, consolidations, and Ensuring Continued Access to Student Loans Act loan purchases. Our engagement was performed in accordance with our contract task order dated September 24, 2010, and our procedures were limited to those described in the Statement of Work dated September 17, 2010 and in the Executive Summary of the attached report. The engagement was performed under the American Institute of Certified Public Accountants (AICPA) Consulting Services: Definitions and Standards (CS Section 100).

Our findings and recommendations resulting from our procedures are provided in the attached report. We appreciate the cooperation and assistance provided to us by the management of Federal Student Aid, the Office of Inspector General and each of the four TIVAS servicers during the course of our work.

This report is intended solely for the information and use of the Office of Inspector General and management of the Department of Education and is not intended to be and should not be used by anyone other than these specified parties. The nature and scope of our services was determined solely by the agreement between Ernst & Young and the Department of Education. Our work was performed only for the use and benefit of the Department of Education, and others who read this report that were not a party to our agreement with respect to the nature and scope of such services do so at their own risk. The services we performed were advisory in nature. Ernst & Young did not render an assurance report or opinion under our contract with the Department of Education, nor did our services constitute an audit, review, examination, or other form of attestation as those terms are defined by the AICPA. None of the services we provided constituted any legal opinion or advice. We did not conduct a review to detect fraud or illegal acts. Notwithstanding anything to the contrary in the contract, we do not assume any responsibility for any third-party products, programs or services, their performance or compliance with the specifications of the Department of Education or otherwise.

Ernst + Young LLP

Ernst & Young LLP
May 16, 2011

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Executive summary

Background

The U.S. Department of Education (Department), through Federal Student Aid (FSA), administers programs that are designed to provide financial assistance to students enrolled in post-secondary education institutions as well as collect outstanding student loan balances. In 2008, Congress enacted the Ensuring Continued Access to Student Loans Act (ECASLA), which authorized the Department to purchase or enter into forward commitments to purchase certain Federal Family Education Loan (FFEL) loans. The Department implemented three activities under this temporary loan purchase authority, which were effective for the 2008-2009 and 2009-2010 academic years:

- Loan Participation Program – the Department purchased a participation interest in FFEL loans, if the loans had been at least partially disbursed. Loans in the participation facility could be either (1) sold (PUT) to the Department once fully disbursed by the lender, or (2) bought back by the lender. The program closed on September 30, 2010.
- Loan Purchase Commitment Program – Lenders could PUT fully disbursed FFEL loans to the Department. Once sold to the Department, they were considered Federally held FFEL loans, and were no longer guaranteed loans. The Loan Purchase Commitment program closed on September 30, 2010.
- Asset-Backed Commercial Paper Conduit – the Department is considered the buyer of last resort to purchase the FFEL loans if the conduit is unable to refinance commercial paper as it matures.

The Affiliated Computer Services (ACS) – Commercial application was used to service certain FFEL loans purchased under ECASLA between September 2008 and June 2010. Its FFEL volume has been since transferred to Title IV Additional Servicers (TIVAS).

In June 2009, FSA awarded four new contracts to acquire additional Title IV student loan management servicing under Federal Acquisition Regulations (FAR) Part 12. The new servicers are commonly referred to as TIVAS and began servicing FFEL loans in September 2009. TIVAS include Sallie Mae (SLM), Nelnet (NN), Great Lakes (GL), and Pennsylvania Higher Education Assistance Agency (PHEAA).

On March 30, 2010, Congress enacted the Student Aid and Fiscal Responsibility Act (SAFRA) – legislation eliminating the origination of new FFEL loans. Beginning July 1, 2010, all student loans are originated through the William D. Ford Federal Direct Loan (DL) program. As a result, all schools participating in the FFEL program transitioned to the DL program. Previously, FSA had one servicing contractor, ACS, to service its DL portfolio. The ACS contract is expected to expire in 2014. As a result, as of September 2010, FSA started to allocate newly originated DL to TIVAS.

Engagement objectives

Both laws (ECASLA and SAFRA) resulted in additional servicing volume, which had to be managed by FSA or its contractors. Ernst & Young was engaged by the Office of Inspector General (OIG) to provide consulting services to assess the current status of the TIVAS servicers to handle the volume of servicing for all new DL originations, consolidations and ECASLA loan purchases. Ernst & Young was engaged to consider the following throughout its assessment: the borrower and loan volume estimation process, servicer allocation methodology, servicing capacity, information technology (IT) and business capacity planning, servicer contingency plans and compliance with contract requirements.

Executive summary

Ernst & Young gathered information on current operations and processes across all TIVAS and provided findings and recommendations to the OIG to be used as baseline information for its future work.

Scope and approach

Ernst & Young conducted the assessment from February 2011 to April 2011 in accordance with scope and objectives defined in agreement with OIG. Site visits and meetings were conducted with both FSA and each TIVAS. The scope of the assessment was defined as follows:

FSA	▸ Borrower and loan volume estimates (budgetary estimates) ▸ Servicer allocation methodology ▸ Fulfillment of contract requirements
TIVAS	▸ Borrower and loan volume estimates (performed by each servicer) ▸ Servicing capacity ▸ Per-borrower estimates/IT and business capacity planning ▸ Contingency plans and processes

In order to gain an understanding of the processes in place for volume estimates, capacity planning, and the ability of servicers to provide adequate service to FSA in light of requirements set forth in the contracts, Ernst & Young reviewed documentation provided by FSA and TIVAS. Documentation that was reviewed included process flows and procedures, relevant system policies, contract requirements and system specifications. In addition, Ernst & Young interviewed process owners from FSA and TIVAS. Through the collection of information from FSA and TIVAS, Ernst & Young compared information across servicers to identify gaps between expectations and requirements set by FSA that may affect satisfactory service delivery. The scope of our work did not require testing and validation of data, therefore, information provided to Ernst & Young by the TIVAS and FSA was assessed as provided and was not subject to additional testing and validation.

The following are the high level procedures performed for each in-scope area:

Borrower and loan volumes (both FSA and TIVAS)	▸ Understand drivers, methodologies and assumptions for both FSA and TIVAS borrower and loan volume costing estimates. ▸ Understand estimate monitoring frequency and process for FSA and TIVAS. ▸ Compare point-in-time estimates to actual volumes allocated to servicers. Understand factors for differences including various programs affecting volume.
Servicer allocation methodology	▸ Understand various legislation, programs, related factors and contract terms affecting allocations. ▸ Understand allocation methodology as it varied between award years. ▸ Understand the ongoing allocation methodology used for new DL originations. ▸ Review the drivers influencing the ongoing allocation methodology: surveys, calculations, frequency and sample sizes.

Executive summary

Fulfillment of contract requirements	▸ Understand the contract requirements review and tracking process managed by FSA (phases two and three only). Understand involvement of process owners effected by each requirement (e.g., users of required reports, system owners of interfaced applications, etc). ▸ Discuss contract requirement implementation with TIVAS to understand process for submitting and obtaining acceptance of submitted artifacts (deliverables provided by TIVAS supporting contract requirements). ▸ For a sample of contract requirements, obtain evidence that artifacts for each TIVAS were submitted, tracked, retained and ultimately accepted by FSA. ▸ Review the FSA Contract Monitoring Plan for activities performed and frequency of monitoring.
Servicing capacity and per-borrower estimates/ capacity planning	▸ Document TIVAS servicing systems configuration (hardware and software). ▸ Understand approach for development of the FSA servicing platform. ▸ Understand capacity planning process for TIVAS. ▸ Determine current maximum capacity. ▸ Obtain servicing capacity estimates given specific hypothetical scenarios.
Servicer contingency planning	▸ Review servicer contingency plans against NIST standards (SP 800-34 and 53). ▸ Understand backup procedures in place and ability to restore IT systems. ▸ Compare servicer contingency plans. ▸ Discuss business operation contingency planning as well as excess volume planning.

Assessment results

Ernst & Young assessed the current status of the TIVAS servicers to handle the volume of servicing for all new DL originations, consolidations and ECASLA loan purchases. Detailed findings and recommendations have been provided in the next section, pages 6 through 9. As a result of our assessment, we found that:

- While FSA has been able to on-board the four TIVAS, FSA should develop more formal retention and management of documentation related to contract requirements and clarifications in order to allow FSA improved oversight of the contract requirements.

- FSA has developed a formal methodology to determine the amount of borrowers to be allocated to each of the TIVAS every year; however, FSA should develop baseline servicing standards and metrics in order to support FSA's goal of improving services and to provide better customer service.

- Currently, no TIVAS is able to support 50 million borrowers, the maximum volume of borrowers for the basic ordering period of five years as required by the contract. However, the TIVAS currently support 13.5 million borrowers collectively and FSA does not anticipate the total amount of borrower volume to grow to 50 million by 2014. FSA should actively monitor the constraints at each TIVAS as it relates to the TIVAS' ability to service borrowers.

Findings and recommendations

#	Area	Finding	Recommendation
1	Borrower estimates [Page 11]	Growth assumptions used by the Department Budget Service office in developing borrower volume growth – as influenced by the macroeconomic environment – are not formally communicated to FSA. Knowledge related to applying factors of the macroeconomic environment to borrower volume growth estimates is held by individuals involved in the process and is based on experience in the field rather than a documented set of economic indicators or specific population indicators.	FSA should obtain information related to the growth assumptions used by the Department Budget Service office for deriving borrower volume growth. The drivers and assumptions and related impact to FSA TIVAS loan allocation estimates should be documented in order to increase process sustainability for FSA and increased transparency to stakeholders.
2	Borrower estimates [Page 17]	FSA performs its own borrower volume estimates. While TIVAS are not contractually required to prepare independent borrower estimates, FSA expects TIVAS to do so in order to plan their operations. Due to several unpredictable variables in the first 18 months of the program, some large discrepancies occurred between TIVAS' estimates of borrowers and actual volumes received from FSA. Despite the volume discrepancies, no major impact was noted to loan servicing, largely due to the servicers' monitoring of their operations and the scalability of their systems. While ongoing allocations are expected to be more predictable (due to allocation methodology put in place and less activity around PUT and split borrower transfers), a communication mechanism has not been defined to relay unexpected changes in volumes to the TIVAS in order to prevent disruptions to borrower servicing.	FSA should work with each TIVAS to understand the specific impact on loan servicing and customer satisfaction levels caused by unexpected increases in servicing volumes. Through the normal contract monitoring communication channels, FSA should use information from its monitoring activities to update estimates as the information becomes available. These estimates and their revisions should be communicated on a regular basis to allow TIVAS to manage acceptable customer service levels. While FSA may choose to communicate estimates of the number of borrowers, and changes to those estimates, it is understood that these communications do not imply a volume to each servicer and are provided for assistance in each servicer's planning process.

Findings and recommendations

#	Area	Finding	Recommendation
3	Capacity planning [Page 30]	Each of the TIVAS indicated that they are not currently able to support 50 million borrowers, the maximum volume of borrowers for the basic ordering period of five years as required by the contract. However, the TIVAS currently support 13.5 million borrowers collectively and FSA does not anticipate the total amount of borrower volume to grow to 50 million by 2014, the end of the basic ordering period. TIVAS stated that they use scalable IT infrastructure to process loans, which would allow them to accommodate loan volume processing in excess of current capacity. While the servicers have indicated the ability to increase their computer processing capacity, their ability to increase staffing and physical space and to deliver training pose constraints in the short term (three to six months). More than six months' notice would be needed for any single servicer to accommodate 50 million borrowers, given the staffing and training constraints.	FSA should work closely with each TIVAS to understand their specific constraints and understand the required lead time necessary to on-board specific loan and borrower volumes. In addition, FSA should implement a process to actively monitor these constraints at each TIVAS and the appropriateness of the required lead time for on-boarding of loan and borrower volumes.
4	Contract requirements [Page 36]	Contract requirements as defined by FSA were documented at a very high level. Detailed requirements were not defined by FSA until after the contract award in June 2009, which provided servicers with a short time frame to understand and implement the initial set of requirements and develop appropriate system design.	For future on-boarding of servicers, FSA should timely communicate the details of system and functionality requirements in order to allow for sufficient planning, development and testing by new servicers prior to the implementation phase.

Findings and recommendations

#	Area	Finding	Recommendation
5	Contract requirements [Page 36]	A final set of detailed requirements, which would aid in on-boarding a new servicer, was not maintained by FSA. Modifications that occurred following the initial implementation were not tracked by FSA and compiled as part of the set of contract requirements; instead they were only captured within the meeting minutes of status meetings between the TIVAS and FSA. In addition, while FSA noted that all servicers provided evidence of their compliance with each requirement clarification, that documentation was not available for each requirement. The source, date and acceptance of each contract requirement and/or clarification was not individually tracked by FSA.	FSA should document the contract requirements and related clarifications in one location. Contract requirements and clarifications should then be used by FSA for oversight and enforcement of contract terms and conditions. For future implementations of servicers, FSA should develop documentation that supports a sustainable on-boarding process. This includes tracking of all clarifications and/or modifications, formal identification of key stakeholders within both TIVAS and FSA, and documented verification of artifact submissions by those business users responsible for various elements of the program. Such documentation could be used in the future to onboard new servicers, as necessary, without incurring similar issues and clarification procedures as in the past.
6	Contingency planning [Page 32]	Server capacity on one servicer's backup server is smaller than the production server, which may result in the slower processing of transactions in the event the backup server was required for processing during an outage of the production server. Management at the servicer is in the process of upgrading its backup servers to meet processing capacity of its production servers.	FSA should implement a process to monitor the contingency planning of each servicer. Monitoring should include capabilities of back up servers and facilities in the event the servicer is required to utilize its non-production environment.

Findings and recommendations

#	Area	Finding	Recommendation
7	Contingency planning [Page 32]	Two of four servicers do not have formally documented processes or flowcharts that identify detailed steps that should be followed to accommodate an unplanned increase in borrower volume transferred from FSA. Currently, these steps would be defined on an ad hoc basis when such an event arises. Both servicers have procedures in place for monitoring system and staffing capacity.	FSA should evaluate the processes in place at each TIVAS to support the on-boarding of excess borrower volumes in an organized and sustainable manner. FSA's process evaluation should include details on the coordination of specific stakeholders to be notified within FSA and TIVAS in the event of a TIVAS receiving borrower volume in excess of plan and/or capacity.
8	Allocation methodology [Page 23]	FSA has not defined minimum survey ratings or maximum delinquency rates for servicers. With defined minimum customer satisfaction levels and maximum delinquency rates, servicers will better understand the ultimate goals of FSA.	FSA should define minimum and maximum servicing standards to support the FSA's goal of improving services to provide better customer service levels. Servicers should be notified of these standards; a monitoring and probation program should be considered to resolve issues before servicers are below the defined minimum standards.
9	Allocation methodology [Pages 21-23]	All metrics used for the ongoing allocation methodology are weighted equally for calculation of the final score for servicers; however, not all appear to be equally important (i.e., number of defaulted borrowers and dollar amounts in default appear to be more significant than results of surveys). In addition, the sampling methodology for school survey population does not take into account number of schools or different types, as such public schools tend to be over-sampled.	FSA should weight evaluation metrics for future allocations to give greater emphasis to metrics that reflect the long-term goals of the Department and FSA. Survey sample sizes should be defined to achieve representative samples from each distinct population group, which would take into account the varying needs of each customer population.

Borrower volume estimates

Supporting information

Borrower volume estimates
Federal Student Aid

- Related to loan servicing, estimates developed by FSA are used for FSA's budgetary purposes (i.e., estimating the cost per month by servicer for loan servicing), not to determine appropriate servicing capacity levels.
- FSA relies on TIVAS to perform their own borrower estimations and servicing capacity planning.
- FSA prepares estimates of borrower volumes based on loan status (e.g., in-school, in-grace/current repayment, deferment/forbearance or delinquent) to determine the cost of serviced loans.
- The estimation process is performed twice a year (January and June) showing projections over three years
  - Estimates are reviewed monthly by FSA CFO, FSA Business Operations (BOPS), and the Department Budget Service office and may be updated if discrepancies are noted that have a significant impact on budgeted amounts.
- FSA utilizes the data provided by the Department Budget Service office, which is based on Common Services for Borrowers (CSB) and National Student Loan Data System (NSLDS) data as well as growth assumptions
  - Growth assumptions are developed by the Department Budget Service office, while the monthly distribution assumptions are developed by FSA BOPS. While certain specific growth figures are provided to FSA BOPS, Department Budget Service does not provide formal documentation of its assumptions and drivers to FSA BOPS. [See Finding #1]

Borrower volume estimates
Federal Student Aid

► Summary of the process used to budget for TIVAS servicing payments:

1	The Department Budget Service office prepares a baseline loan volume estimate (total dollar amount of loans, as well as loan borrower count) for DL and FFEL loans based on information from CSB and NSLDS. Using these figures, the Department Budget Service office then applies assumptions on growth.
2	FSA BOPS uses the borrower count from the Department Budget Service and reduces this number by a percentage based on historical information (CSB, NSLDS) to estimate a number of borrowers expected to be new to the system.
3	FSA BOPS distributes new borrower estimate over 12 months using monthly distribution historical trends.
4	FSA BOPS uses current actual volume and adds in new volume estimates as they are expected to enter the system to determine a total borrower volume for each month of the year.
5	FSA BOPS uses historical trends to estimate a percentage of borrowers expected to be in specific types of loan status (in-school, in-grace, current repayment, deferment/forbearance or delinquent) to estimate costs, as cost varies by loan status.

Borrower volume estimates
TIVAS

- TIVAS estimate the number of borrowers who will be new to their system and total number of borrowers being serviced at a point in time.
- TIVAS use their estimates to project an expected volume of loans (based on estimated volume of borrowers) and required processing capacity.
- Loan volume is significant for computer processing and storage due to the data and processing associated with each loan.
- Borrower volume is significant to both staffing levels and servicer revenue. Staffing is significant as one borrower, regardless of the number of loans likely, can be assisted by one individual servicer representative. The borrower volume is significant to revenue because servicers are only paid based on the number of borrowers in their system in a specific status. Servicers are not paid additional amounts if the borrower has multiple loans.
- In the first 13 months (September 2009 – September 2010), loan transfers by FSA to TIVAS were mainly the result of qualified FFEL loans sold (PUT) to the Department by various lenders. Newly originated DL started to be allocated in June 2010.
- PUT volume could be either:
  - "On the system" – Each TIVAS performs servicing for various lenders as a part of their commercial business. In addition the TIVAS may be lenders themselves. In the case where one of the TIVAS was the current servicer (either as a lender, or a contracted servicer for a third-party lender) of the loan being PUT – loans were kept with the same servicer to limit disruption to the borrower. For these loans, the TIVAS would migrate the loans from its commercial servicing systems to its federal servicing system (an internal transfer).
  - "Off the system" – loans being PUT that had not been previously serviced by one of the TIVAS.

NOTE: "System" refers to the servicing system or application used by TIVAS.

Borrower volume estimates

TIVAS – FFEL PUTs

- Servicers used different methods to estimate FFEL PUT volume based on the knowledge and relationships they may have had with lenders on their commercial system.
  - **TIVAS A** [redacted]
  - **TIVAS B** [redacted]
  - **TIVAS C** [redacted]
  - **TIVAS D** [redacted]

Borrower volume estimates
TIVAS estimation process summary

	TIVAS A	TIVAS B	TIVAS C	TIVAS D
Estimate drivers	[redacted]			
Timing/ frequency				
Monitoring				

Borrower volume estimates
Estimates vs. actuals

FSA/TIVAS	October 2010	November 2010	December 2010
FSA estimate	12,277,492	12,539,333	12,674,665
FSA actual	13,002,494	13,265,127	13,378,910
Percentage difference	5.91%	5.79%	5.56%
TIVAS A estimate	[redacted]	[redacted]	[redacted]
TIVAS A actual	[redacted]	[redacted]	[redacted]
Percentage difference	[redacted]	[redacted]	[redacted]
TIVAS B estimate***	[redacted]	[redacted]	[redacted]
TIVAS B actual	[redacted]	[redacted]	[redacted]
Percentage difference	[redacted]	[redacted]	[redacted]
TIVAS C estimate	[redacted]	[redacted]	[redacted]
TIVAS C actual	[redacted]	[redacted]	[redacted]
Percentage difference	[redacted]	[redacted]	[redacted]
TIVAS D estimate	[redacted]	[redacted]	[redacted]
TIVAS D actual	[redacted]	[redacted]	[redacted]
Percentage difference	[redacted]	[redacted]	[redacted]

* TIVAS C [redacted]

** TIVAS D [redacted]

*** TIVAS B [redacted]

- 2010 Q1-Q3 estimates had a number of variables due to the type of allocations made during that period. Therefore, the table compares only 2010 Q4 estimates to actuals.
- The above estimates were made in late 2009, typically December 2009. Estimates are for the borrower volume expected for October – December 2010 by servicer, or in total for FSA.

Borrower volume estimates
Estimates vs. actuals

- Factors to consider when evaluating accuracy of borrower volume estimates performed by FSA and TIVAS:
  - Allocations in Year 1 (Sep. 1, 2009 – Aug. 14, 2010) included mostly FFEL and delinquent conduit transfers from lenders, based on existing relationships between servicers and sellers/ lenders. TIVAS only knew the volume of FFEL loans/borrowers on their systems ("PUT" by lenders serviced on their commercial system).
  - Transfers of split borrowers between servicers could not be practically estimated by the TIVAS, as it would be difficult to identify a borrower on two separate systems while determining which of the servicers with a split would ultimately end up servicing the borrower. FSA determined that in the case of split borrowers, the servicer with the lower allocation of borrowers at the time the split was addressed would ultimately service that borrower.
  - DL allocations were not considered for 2010 estimates. SAFRA legislation was not passed until March 2010, and most initial annual estimates were completed at the end of 2009.
- While some large differences between estimates and actuals for individual servicers are observed [redacted] estimates for all servicers in total are very close to FSA's estimates [redacted] [See Finding #2]
- The servicing capacity review shows that servicers are able to accommodate large increases in volumes given sufficient notice and lead time.

Allocation methodology

Supporting information

Allocation methodology
Transfer types

- Allocation of borrowers to TIVAS addresses various transfer types:
  - **Purchases and Participation (PUTs)** – Fully disbursed FFEL loans purchased by the Department as part of the “loan participation program” or the “loan purchase commitment program” from various lenders. This transfer is applicable only between 9/2009 – 10/2010.
  - **Conduit delinquent** – FFEL loans that were purchased by the Department, as a buyer of last resort, when the loan becomes delinquent and is removed from the conduit. (Note: Conduit is also subject to other PUT events until 1/2014)
  - **FFEL transfers from ACS-FFEL** – FFEL loans serviced by ACS (Long Beach, CA). This transfer is mainly applicable for year one. Very low volume in year two.
  - **DL transfers from ACS-DL** – DL serviced by ACS (Germantown, MD) for “split borrowers.” This transfer is mainly applicable for year two onward.
  - **COD originations** – New originations of DL. This transfer is mainly applicable for year two onward.

Allocation methodology
Allocation types

Transfer type	Year one – September 1, 2009-August 14, 2010	Year two – August 15, 2010 – August 14, 2011
Overall allocation year goal	Conclude year with equal borrowers for each TIVAS	Allocation of borrowers based on calculated allocation percentages. See slide 22 for details on allocation calculation
Purchases and participation	Based on TIVAS existing relationship with the seller, current workload and expected count at year-end; if no relationship – assigned to TIVAS with lowest number of borrowers	*Same as year one* - Sales closed after 9/30/2010 are allocated and counted in year two (earlier sales are considered year one sales).
Conduit delinquent	Based on TIVAS existing relationship with the seller, current workload and expected count at year-end; if no relationship – assigned to TIVAS with lowest current volume	Each conduit seller/servicer was assigned a TIVAS servicer to handle all of that seller/servicer's sales during year one. That relationship was retained in year two.
FFEL transfers from ACS-FFEL	Based on TIVAS existing relationship with the seller; if no relationship – assigned to TIVAS A, TIVAS B or TIVAS C based on the servicer with the lowest number of borrowers (TIVAS D – none due to large PUT transfers)	All transfers to a single TIVAS (TIVAS A) due to very low volume (anticipated < 15,000 borrower).
DL transfers from ACS-DL	Not applicable in year one.	Only borrowers with loans already at one of the TIVAS are transferred. These transfers are executed to resolve "split borrowers" and move borrower's loans to a single servicer.
COD originations	If borrower is an existing borrower – loan assigned to servicer with existing borrower relationship; if a new borrower – Loan Distribution Engine (LDE) assigns based on percentages entered by FSA, which were adjusted periodically with the goal of making an even distribution among TIVAS	Same as year one; however, FSA adjusted LDE percentages with the goal of allocating a specific percentage (of the total borrower volume) to each servicer based on their allocation methodology score.

Note: Starting August 15, 2011, the ongoing allocation methodology will be used for allocation. See slides 21 and 22 for more details.

Allocation methodology
"Ongoing" allocation

- Contracts were designed to incentivize TIVAS to obtain higher satisfaction rates and lower default rates.
- "Ongoing" contracted allocation method
  - Only new DL, FFEL purchase/participation borrowers (allocated after August 15, 2010 or "year two") and conduit delinquent loans are counted for "ongoing" allocation distribution[1]).
  - Allocation is based on five factors:
    - Default[2] dollar amount (as a percentage of total dollars for each servicer) – Encouraged TIVAS to maintain a low value for borrowers in default.
    - Default borrower rate (as a percentage of total borrowers for each servicer) – Incentivizes TIVAS to not only focus on large dollar amount defaults but to aid all borrowers.
    - School survey – Measures school satisfaction when interacting with TIVAS.
    - Borrower survey – Measures borrower satisfaction when interacting with TIVAS.
    - FSA representative survey – Measures FSA satisfaction when interacting with TIVAS.
  - TIVAS are ranked on each of the five factors equally (i.e., 20% each) [See Finding #9]

1: Historical information is required to rank servicers (e.g., survey results). As a result, year one did not utilize the standard allocation methodology, so allocation for each loan type varied (see slide 20).

2: Borrowers in default are defined as loans that have been sent to Debt Management and Collection System (DMCS) or are greater than 360 days delinquent at the end of the quarter.

Allocation methodology
"Ongoing" allocation

Metric[1]	Description	Factors considered
Value of portfolio considered in default	Percentage of "In Repayment" portfolio dollars that go into default (percent in public schools, private schools, proprietary schools)	▸ Principal balance outstanding and interest of loans transferred to DMCS or more than 360 days delinquent during the period ▸ Principal balance outstanding and interest of all loans in "repayment" status
Unique borrowers considered in default	Percentage of unique "In Repayment" portfolio borrowers that go into default (percent in public schools, private schools, proprietary schools)	▸ Number of delinquent borrowers transferred to DMCS or more than 360 days during the period ▸ Number of all borrowers in "repayment" status
Surveys – borrowers	Measure of borrower satisfaction with servicer (0-100%) (In school, in grace, and in repayment borrowers)	▸ Phone surveys for borrowers are conducted by the CFI Group, an independent survey company, across all borrowers (target is 900-1000 borrower surveys for each servicer per year) ▸ Phone surveys for schools conducted the by CFI Group for each school type (target is 300 school surveys for each servicer per year) ▸ Online FSA surveys are administered by the CFI Group and sent to all personnel interacting with TIVAS (there are about 90 FSA employees surveyed, with an average response rate of 42%) ▸ All surveys are designed to prompt respondents to think about the type of service they receive by asking specific questions on individual occurrences; however, only three questions are used for ranking.[2] These questions provide a standardized system for rating customer satisfaction in various industries.
Surveys – schools	Measure of school satisfaction with servicer (0-100%) (public schools, private schools, proprietary schools)	
Surveys – FSA personnel	Measure of FSA satisfaction with servicer (0-100%)	

[1] Each metric is measured quarterly. Quarterly scores are averaged as of July 1 of each year to provide a year end score.

[2] American Customer Satisfaction Index (ACSI) Survey Ranking Questions:

- Using a 10-point scale on which "1" means "very dissatisfied" and 10 means "very satisfied," how satisfied are you with **[servicer]**?
- Using a 10-point scale on which "1" now means "falls short of your expectations" and "10" means "exceeds your expectations," to what extent has **[servicer]** fallen short of or exceeded your expectations?
- Imagine what an ideal process would be for dealing with your loan servicer. How well do you think **[servicer's]** current process compares with that ideal you just imagined? Please use a 10-point scale on which "1" means "not very close to the ideal," and "10" means "very close to the ideal."

Allocation methodology

“Ongoing” allocation calculation

Year two allocation metrics				
Metric	**TIVAS 1**	**TIVAS 2**	**TIVAS 3**	**TIVAS 4**
Default borrower rate (points awarded)	.46% (2)	.55% (1)	.27% (3)	.25% (4)
Default amount rate	.19% (2)	.25% (1)	.14% (3)	.12% (4)
Borrower survey	69.44 (4)	65.67 (1)	67.11 (2)	68.78 (3)
School survey	74.78 (2)	75.78 (3)	79.00 (4)	74.67 (1)
Federal personnel survey	65.00 (1)	69.33 (2)	73.33 (4)	71.67 (3)
Total points awarded	**11**	**8**	**16**	**15**
Allocation percentage	**22%**	**16%**	**32%**	**30%**

- Points are awarded based on rank as related to other servicers. Allocation percentage is determined by dividing the servicer’s total points by the total available points (50).
  - Lowest allocation percentage (assuming one point in all metrics) is 10%
  - Highest allocation percentage (assuming four points in all metrics) is 40%
- FSA does not define a minimum score in any category or in total to continue servicing.
  - Servicers will only be discontinued if they do not comply with contract requirements; customer satisfaction and default rate are not included as cause for discontinuing contracts [See Finding #8]

Servicing capacity and per-borrower estimates

Supporting information

Servicing capacity and per-borrower estimates
Background

- We discussed with each servicer the capacity constraints and scalability of each servicer's operations.
  - We obtained documentation from each servicer and held meetings to become familiar with the IT infrastructure and systems used by the servicers. In addition, we discussed the process to develop the systems used for FSA portfolio processing.
  - We discussed with each servicer the business planning and monitoring process as it relates to IT infrastructure and operational factors (personnel, physical space, etc.).
- We obtained responses from each servicer on hypothetical scenarios for accommodating additional volume at defined intervals to determine the key factors and considerations each servicer makes when addressing excess volume.

Servicing capacity and per-borrower estimates
IT infrastructure and systems – current state

	TIVAS A	TIVAS B	TIVAS C	TIVAS D
Servicing system	[redacted]	[redacted]	[redacted]	[redacted]
Hardware	[redacted]	[redacted]	[redacted]	[redacted]
CPU in use, remaining capacity on demand	[redacted]	[redacted]	[redacted]	[redacted]
Average CPU utilization	[redacted]	[redacted]	[redacted]	[redacted]
Database type	[redacted]	[redacted]	[redacted]	[redacted]
Current disk utilization	[redacted]	[redacted]	[redacted]	[redacted]

Average CPU utilization refers to the percentage of the processor in use, the excess capacity is not used and remains idle. Additionally, **Current disk utilization** refers to the percentage of disk space used, the remaining percentage is idle and is not in use for any other purposes.

Note: Individual components of servicing systems are presented above; however, the adequacy of each servicing system depends on the entire system which includes the people, process and technology driving the servicers operations.

Servicing capacity and per-borrower estimates
Systems capacity summary

- Each mainframe system may host multiple services (other than FSA loan processing). Utilization figures noted relay the total utilization for each processor or disk array inclusive of processing for FSA. [redacted]
- Each servicer currently has excess disk space and processing capacity, therefore, each servicer is able to handle current loan volumes as well as growth projected by each servicer.
- The nature of each servicer's IT environment appears to be scalable to accept greater servicing volume with appropriate lead time.
  - [redacted]
  - [redacted]
- Data storage for all servicers is [redacted], which appears to allow enough head room for additional volume.
  - The nature of the systems also allows for near overnight data capacity expansion. In an emergency situation, it appears the systems could scale within a matter of days.

Servicing capacity and per-borrower estimates
Systems development summary

- Each servicer leveraged existing commercial systems to meet FSA requirements for servicing.
  - [redacted]
- FSA data appeared to be segregated for all servicers either using separate databases for each portfolio (FSA vs. commercial) or through controls that allow access only to cleared individuals.
- Modifications made to TIVAS systems were designed to follow a change management process that included systems testing, user testing, and business/technical approval for modifications.

Note: Ernst & Young obtained the above information through review of servicer reports and discussions with servicers. Ernst & Young did not independently verify the change management or logical access processes.

Servicing capacity and per-borrower estimates
Capacity scenarios

- Three hypothetical scenarios were proposed to each TIVAS to allow for comparison of their ability to increase FSA servicing capacity. We proposed scenarios in which the servicer was notified on December 31, 2010, of an increase in volume to occur on one of these three dates:
  - January 1, 2011 – On this day, with no system upgrades or increased capacity on demand, what volume of borrowers could be serviced by the current servicing platform with no change in full-time employee (FTE) count? This scenario is based on strictly servicing system capacity.
  - March 1, 2011 – Given 60 days notice, what volume of borrowers could be serviced? This scenario takes into account system capacity as well as need to onboard FTEs.
  - June 30, 2011 – Given six months' notice, what volume of borrowers could be serviced? This scenario takes into account system capacity as well as need to onboard FTEs.
- Main assumptions related to scenarios:
  - January 1, 2011 scenario:
    - No additional staffing needs were taken into account, resulting in possible decrease in customer satisfaction level.
  - March 1, 2011 and June 30, 2011 scenarios:
    - Servicers were required to keep an equal ratio of borrowers to FTE in each department serving borrowers (inbound and outbound call center, and back office operations affected by number of borrowers served), as compared to their ratios as of December 31, 2010. Servicers took into account their ability to acquire staff and physical space, as well as training.
    - Servicers were required to assume an equal ratio of loans "in repayment" to "not in repayment" when compared to their current, December 31, 2010, portfolio.
    - Servicing system upgrades were allowed that could be completed prior to the specified date.

Servicing capacity and per-borrower estimates
Capacity scenario results

- Summary results of the Ernst & Young proposed scenarios for each TIVAS:

		TIVAS A	TIVAS B	TIVAS C	TIVAS D
Current 12/31/2010 [See Finding #3]	Borrowers	[redacted]			
	Total loans				
	Inbound/outbound call center FTE				
	Support FTE				
	Total FTE				
One day 1/1/2011[2]	Borrowers				
	Total loans				
	FTE (no change from 12/31/10)				
	Increase in borrowers over current volume				
60 days 3/1/2011	Borrowers				
	Total loans				
	Total FTE				
	Increase in borrowers over current volume				
Six months 6/30/2011	Borrowers in repayment				
	Total loans				
	Total FTE				
	Increase in borrowers over current volume				

- Without set FTE ratio constraints, all servicers are able to scale their IT system to meet larger volume increases than stated in the table above. [redacted]

2: Increases in capacity were constrained by: inability to upgrade (one-day), or inability to onboard and train adequate number of employees (60 days and six months).

Contingency planning

Supporting information

TIVAS contingency planning

	TIVAS A	TIVAS B	TIVAS C	TIVAS D
NIST 800-34 compliance	Yes	Yes	Yes	Yes
Business impact analysis	Yes	Yes	Yes	Yes
Recovery testing	[redacted]	[redacted]	[redacted]	[redacted]
Test meets required 72-hour recovery objective	Yes	Yes	Yes	Yes
Backup method	[redacted]	[redacted]	[redacted]	[redacted]
Primary data center site	[redacted]	[redacted]	[redacted]	[redacted]
Recovery site	[redacted]	[redacted]	[redacted]	[redacted]
Additional notes	[redacted]	[redacted] [See Finding #6]	[redacted]	[redacted]

Note: Ernst & Young did not perform testing of contingency planning performance. Contingency plans and servicer-provided test summaries were used to prepare the information above. Ernst & Young reviewed contingency plans to determine if it appeared the servicers had select components of a NIST 800-34 contingency plan. [See Finding #7]

Fulfillment of contract requirements

Supporting information

Contract requirement fulfillment

- Timeline showing the key dates associated with the TIVAS contracts award and fulfillment of contract terms.

NOTE: Per the contract requirements, each TIVAS is required to be able to service up to 50 million borrowers over the base period of the contract (five years). Based on existing staffing, each TIVAS is not currently able to support 50 million borrowers without sacrificing customer service level. However, in December 2010, the TIVAS supported 13.5 million borrowers collectively (with another 12 million serviced by ACS) and FSA does not anticipate the total amount of borrower volume to grow to 50 million by 2014, the end of the basic ordering period.

Q1 2009
TIVAS submitting proposals begin systems development

June 2009
Contracts awarded

August 31, 2009
Initial requirements due (phase 1)

March 31, 2010
Intermediate requirements target due date (phase 2)

April 30, 2010
Actual phase 2 completion

August 31, 2010
Full requirements target due date(phase 3)

November 30, 2010
Actual phase 3 completion

Contract requirement fulfillment
Requirement development

- Phase two and phase three contract requirements were comprised of approximately 110 requirements related to general/legal, financial reporting, internal controls, reconciliation, other reporting, security (physical, systems, etc.), records management and DL.
- Requirements were documented in attachments to the original TIVAS contracts and were ultimately refined with detailed clarifications.
- Servicers were required to implement the terms of the contract by March 31, 2010 (phase two) and August 31, 2010 (phase three). Actual implementation lagged to April 30, 2010 and November 30, 2010, respectively.
- Most original requirements had clarifications or further details added, therefore, clarifications became de facto requirements.
- FSA provided all clarifications through a single implementation team to TIVAS, and met with all TIVAS regularly on each requirement area to determine if additional information was required.

Contract requirement fulfillment
Requirement implementation

- The FSA implementation team served as liaisons to distribute clarifications as well as obtain artifacts validating that requirements were met.
- The FSA implementation team often validated that submissions met expected standards; for certain requirements, artifacts were validated by appropriate stakeholders.
  - Documentation identifying requirements stakeholders (e.g. report owner, system interface owner, data set owner) was not maintained by FSA. Additionally, sign-off and user acceptance of artifacts submitted by TIVAS to FSA were not formally documented and maintained by the FSA implementation team.
- Contracts were awarded in June of 2009, and TIVAS were required to start initial servicing in September 2009. Therefore in order to begin servicing and meet all requirements by September 2009, some of the system development had to be initiated prior to contract award. This resulted in the following:
  - Detailed contract requirements (i.e., clarifications) were not available timely for TIVAS, therefore, all servicers had to work under accelerated systems development timetables. [See Finding #4]
  - Clarifications were not ultimately consolidated to create a list of future requirements for potential new servicer onboarding. [See Finding #5]

Contract requirement fulfillment
Review of artifacts submitted

- The sample selection for contract requirements was performed as follows:
  - A haphazard sample of 10 detailed contract requirements were selected.
  - Selection focused on items that required artifact submission rather than confirmations and/or acknowledgements provided by the servicer in response to a requirement (e.g., legal requirements). The population (approximately 361) was from the full set of phase two and three contract clarifications.
- For each selected requirement we requested supporting evidence from FSA for each servicer's fulfillment of that requirement.
- FSA did not maintain a detailed tracking document noting the dates of submission, where data was submitted from, and who validated the data.
- Evidence of stakeholder (e.g., report owner, system interface owner, data set owner) acceptance of artifacts was not always maintained by the FSA implementation team, only summary level acceptance from the implementation coordinator was maintained.
- Evidence of artifacts for some requirements was not consistently maintained by FSA.
  - For one of the ten requirements selected, no artifacts were provided supporting the requirement for any servicer.
    - Requirement 631: Requirement for servicers to report each collection activity (e.g., Collection of Principal, Collection of Interest, etc.) using unique identifiers in transaction level data.
  - For one requirement, artifacts were not maintained for a single servicer.
    - Requirement 697: Requirement for servicers to report on Teacher Education Assistance for College and Higher Education (TEACH) Grants that have been converted to Direct Unsubsidized TEACH Loans separately from other DL.

Appendix A
FSA responses to findings and recommendations

FSA responses to findings and recommendations

#	Area	Recommendation	FSA response	EY/OIG response
1	Borrower estimates	FSA should obtain information related to the growth assumptions used by the Department Budget Service office for deriving borrower volume growth. The drivers and assumptions and related impact to FSA TIVAS loan allocation estimates should be documented in order to increase process sustainability for FSA and increased transparency to stakeholders.	FSA concurred with the recommendation.	None.
2	Borrower estimates	FSA should work with each TIVAS to understand the specific impact on loan servicing and customer satisfaction levels caused by unexpected increases in servicing volumes. Through the normal contract monitoring communication channels, FSA should use information from its monitoring activities to update estimates as the information becomes available. These estimates and their revisions should be communicated on a regular basis to allow TIVAS to manage acceptable customer service levels.	FSA did not specifically disagree with the recommendation to work with each TIVAS to understand the impact caused by unexpected increases in servicing volumes. FSA noted that it recognizes the importance of working closely with the TIVAS and has established multiple channels of communicating with the TIVAS to share information and concerns related to ongoing or potential issues, including unexpected volume growth. FSA concurred with the balance of the recommendations.	Based on discussions with officials at FSA, estimates of borrower volumes were communicated to TIVAS. However, based upon discussions with officials at the TIVAS, we found that not all TIVAS could identify such communication occurring. As a result, FSA may not have received adequate feedback from the TIVAS into the impact that unexpected increases in borrower volumes could have on each TIVAS' loan servicing capability and customer service level. While the finding has been revised to clarify this information, the recommendation remains unchanged.

FSA responses to findings and recommendations

#	Area	Recommendation	FSA response	EY/OIG response
3	Capacity planning	FSA should work closely with each TIVAS to understand their specific constraints and understand the required lead time necessary to on-board specific loan and borrower volumes. In addition, FSA should implement a process to actively monitor these constraints at each TIVAS and the appropriateness of the required lead time for on-boarding of loan and borrower volumes.	FSA believes that under the contracts each TIVAS is responsible for ensuring adequate capacity planning. If an individual TIVAS fails to have adequate capacity, the Department can shift the loan volume to other servicers. In addition, no concerns have been raised regarding the one-month lead time contained in the contracts. FSA believes that the TIVAS can quickly increase servicing capacity.	While each TIVAS is responsible for ensuring adequate servicing capacity pursuant to the terms of the contract, FSA should proactively work with and monitor each TIVAS to ensure that no capacity issues arise and to avoid any disruptions in the proper servicing of borrowers' loans. For example, if a TIVAS receives a loan that it is unprepared to service, a borrower's first payment date may be delayed.
4	Contract requirements	For future onboarding of servicers, FSA should timely communicate the details of system and functionality requirements in order to allow for sufficient planning, development and testing by new servicers prior to the implementation phase.	FSA concurred with the recommendation.	None.

FSA responses to findings and recommendations

#	Area	Recommendation	FSA response	EY/OIG response
5	Contract requirements	FSA should document the contract requirements and related clarifications in one location. Contract requirements and clarifications should then be used by FSA for oversight and enforcement of contract terms and conditions. For future implementations of servicers, FSA should develop documentation that supports a sustainable onboarding process. This includes tracking of all clarifications and/or modifications, formal identification of key stakeholders within both TIVAS and FSA, and documented verification of artifact submissions by those business users responsible for various elements of the program. Such documentation could be used in the future to onboard new servicers, as necessary, without incurring similar issues and clarification procedures as in the past.	FSA concurred with the recommendation to document the contract requirements and related clarifications in one location. In addition, FSA noted that it has developed a sustainable onboarding process to be used in the onboarding of not-for-profit loan servicers.	None.

FSA responses to findings and recommendations

#	Area	Recommendation	FSA response	EY/OIG response
6	Contingency planning	FSA should implement a process to monitor the contingency planning of each servicer. Monitoring should include capabilities of back-up servers and facilities in the event the servicer is required to utilize its non-production environment.	FSA noted that each TIVAS was required to meet back-up and disaster recovery requirements, and that each TIVAS' contingency plan was reviewed and approved by FSA. The contracts were designed to eliminate the need for excessive monitoring, instead relying on competition across vendors to ensure performance. If a TIVAS is unable to perform as required, FSA can transfer the borrower volume to another servicer.	While each TIVAS is responsible for ensuring adequate contingency planning pursuant to the terms of the contract, FSA should proactively work with each TIVAS to ensure that adequate plans and capabilities are in place or provided for in order to avoid any disruptions in the proper servicing of borrowers' loans. FSA should not solely or predominately rely upon competition among the servicers as a means of ensuring the adequate performance of each TIVAS. For example, improper contingency planning could result in the loss of data concerning a borrower's payment history; the loss of such data could make the loan unenforceable.
7	Contingency planning	FSA should evaluate the processes in place at each TIVAS to support the on-boarding of excess borrower volumes in an organized and sustainable manner. FSA's process evaluation should include details on the coordination of specific stakeholders to be notified within FSA and TIVAS in the event of a TIVAS receiving borrower volume in excess of plan and/or capacity.	FSA believes that the TIVAS maintain both the incentive and capability to ensure that increases in borrower volume can be serviced in accordance with the contract terms.	While each TIVAS is responsible for ensuring adequate servicing capacity pursuant to the terms of the contract, FSA should proactively work with each TIVAS to ensure that adequate plans are in place to address unexpected volume increases so as to avoid any disruptions in the proper servicing of borrowers' loans.

FSA responses to findings and recommendations

#	Area	Recommendation	FSA response	EY/OIG response
8	Allocation methodology	FSA should define minimum and maximum servicing standards to support the FSA's goal of improving services to provide better customer service levels. Servicers should be notified of these standards; a monitoring and probation program should be considered to resolve issues before servicers are below the defined minimum standards.	FSA disagreed with this recommendation. The performance-based contracts established a performance structure to motivate each TIVAS to improve customer service, rather than meet a specific minimum performance level. FSA is satisfied with the TIVAS' overall performance and its reduced monitoring responsibilities and costs.	As noted in the report, an individual TIVAS could rate poorly in all metrics relative to the other TIVAS and still receive a borrower allocation of 10% under the contract structure. The contracts do not contain specific provisions to mitigate and address a contractor's poor customer service and default prevention.

FSA responses to findings and recommendations

#	Area	Recommendation	FSA response	EY/OIG response
9	Allocation methodology	FSA should weight evaluation metrics for future allocations to give greater emphasis to metrics that reflect the long-term goals of the Department and FSA. Survey sample sizes should be defined to achieve representative samples from each distinct population group, which would take into account the varying needs of each customer population.	FSA disagreed with the recommendation to weight evaluation metrics. FSA believes that the contracts reflect FSA's Strategic Goals to (1) provide superior service and information to students and borrowers, (2) provide efficient processes and effective capabilities that are among the best in the private and public sectors, and (3) ensure program integrity and safeguard taxpayers' interest. In regards to the recommendation concerning sample sizes, the sample sizes used provide a statistically valid representation of the overall population of customers. FSA did not explain why all the evaluation metrics are of equal importance. FSA will consider changes in the sampling methodology to obtain the most reliable information available given constraints related to costs, resources and customer response rates.	Under the current weighting of evaluation metrics, 60% of total points are based on customer surveys (that is, borrower, school, and FSA personnel surveys are weighted at 20% each) and 40% of total points are based on default measurements (that is, dollars in default and borrowers in default are weighted at 20% each). As such, the allocation methodology under weights the input of the ultimate customer, that is the borrower, and the negative financial impact on the Department associated with defaulted loans.

Appendix B
FSA original responses to findings and recommendations

UNITED STATES DEPARTMENT OF EDUCATION

MEMORANDUM

AUG 10 2011

TO: Keith West
Assistant Inspector General for Audit Services
Office of Inspector General

[redacted]

FROM: James W. Runcie
Acting Chief Operating Officer
Federal Student Aid

SUBJECT: Response to Draft Consulting Report, "Title IV Additional Servicers Capacity Review" ED-OIG/S15L0001.

Thank you for providing us with an opportunity to comment on the draft consulting report prepared by Ernst & Young, LLP (E&Y) on behalf of the Office of Inspector General (OIG). E&Y's objective was to assess the Title IV Additional Servicers' (TIVAS) ability to handle the volume of servicing for all new Direct Loan Program loan originations, consolidations and loans purchased under the Ensuring Continued Access to Student Loans Act (ECASLA) of 2008.

We are pleased that E&Y's report recognized that Federal Student Aid (FSA) successfully responded to the revolutionary changes that dramatically impacted both loan programs between 2008 and 2010. The passage of ECASLA ensured that students would continue to receive federal student loans and the passage of the Student Aid and Fiscal Responsibility Act (SAFRA) eliminated the origination of new Federal Family Education Loans, and required that all new student loans be made under the Direct Loan Program. OIG has reported on FSA's successes in managing the loan volume increases due to changing student loan market conditions and legislative mandates in two Management Information Reports issued previously.

E&Y's draft consulting report suggests that FSA could make the following improvements: develop more formal retention and management of documentation related to contract requirements and clarifications to improve oversight of the contract requirements; develop baseline servicing standards and metrics to achieve FSA's goal to provide better customer service and improve services; and lastly, actively monitor the constraints at each TIVAS as it relates to the TIVAS' ability to service borrowers.

As you know, the TIVAS' contracts are unique and are designed to meet the needs of the loan programs, create a more responsive and nimble government capability (emphasis on capacity and infrastructure), increase customer service, reduce the government investment for ongoing performance management, as well as protect taxpayers' and students' interests. The TIVAS agreements are structured to achieve these goals in two distinct ways.

First, contrary to the commercial loan servicing cost structure, these contracts include a pricing model that incentivizes the servicers to keep borrowers in current repayment and out of delinquency/default, by allowing servicers to invoice higher rates for borrowers in repayment versus lower rates for borrowers who are delinquent. This ensures that borrowers are kept in good financial standing, while increasing the chances that the government will recoup the funds lent to borrowers for their education. Secondly, these contracts utilize a true "performance-based" approach to driving performance. Instead of using conventional performance measurements or service-level agreements, the servicers are measured on their ability to: (1) keep borrowers out of default; and (2) increase customer satisfaction. To accomplish this, the TIVAS are measured on the following five factors:

- percentage of portfolio dollars in default;
- percentage of portfolio borrowers in default;
- borrower satisfaction;
- school satisfaction; and
- FSA satisfaction.

Based on these factors, the TIVAS are engaged in an ongoing competition with each other whereby they are ranked every year based on their performance results, and are assigned new borrower volume for the upcoming year based on their performance rankings. As a result, the TIVAS' ability to keep default numbers low, and customer satisfaction high, has a direct impact on their ability to earn additional revenue. This approach also reduces the overall cost to the federal government by easing the amount of performance monitoring and oversight that would otherwise be required to manage traditional performance metrics. Further, the competitive nature of the agreements drives vendors to improve customer service and portfolio performance, as well as to improve available capacity.

By structuring the TIVAS contracts to encourage servicers to increase customer satisfaction and reduce defaults, the following FSA Strategic Goals for Fiscal Years 2011-2015 are addressed directly:

- Strategic Goal A - "Provide superior service and information to students and borrowers."
- Strategic Goal C - "Develop efficient processes and effective capabilities that are among the best in the private and public sectors."
- Strategic Goal D – "Ensure program integrity and safeguard taxpayers' interest."

Ultimately, a TIVAS' primary motivation is to maintain high levels of performance to increase the prospect of increasing revenue through the allocation of additional borrower accounts. Thus, as a function of accepting and servicing the additional borrower accounts, it is incumbent upon the servicer to ensure that it has the necessary infrastructure to adapt to the volume that it earns. In the event that a servicer is unprepared to handle additional incoming volume, or does so at the expense of decreased customer service levels, the servicer risks a reduced allocation in future years pursuant to the contract's performance-based methodology. Further, in the event that government requirements are not adequately met, a reduction in the servicer's current servicing volume may occur as well. Therefore, FSA believes that the TIVAS maintain both the incentive and capability to ensure that infrastructure needs are readily scalable in advance of incoming volume, in accordance with the terms of the contracts.

In the attachment to this memorandum, we respond to each of the findings and recommendations in greater detail.

Thank you once again for the opportunity to respond to E&Y's consulting report.

Attachment

cc: Susan Szabo
John Kane
Ann Manheimer
Patrick Bradfield
Michael Whisler
John Hurt

ATTACHMENT

Finding Area: Borrower Estimates

Recommendation: FSA should obtain information related to growth assumptions used by the Department's Budget Service office for deriving borrower growth. The drivers and assumptions and related impact to FSA TIVAS loan allocation estimates should be documented in order to increase process sustainability for FSA and increased transparency to stakeholders.

FSA's Response: We agree with this recommendation. We will obtain and review the documentation from the Department's Budget Service for use in the process for developing borrower volume estimates.

Recommendation: FSA should work with each TIVAS to understand the specific impact on loan servicing and customer satisfaction levels caused by unexpected increases in loan volumes.

FSA's Response: We recognize the importance of working closely with the TIVAS. FSA has established and will continue to utilize a variety of interfaces with TIVAS representatives, including weekly operations meetings, monthly steering committee meetings, and ongoing informal discussions with the Contracting Officer and other FSA staff. All of these interactions afford opportunities for the TIVAS and FSA staff to share information and concerns related to the impact of ongoing or potential issues, including unexpected volume growth.

Recommendation: Through the normal contract monitoring communication channels, FSA should use information from its monitoring activities to update the estimates as the information becomes available. These estimates and revisions should be communicated on a regular basis to allow TIVAS to manage acceptable customer service levels.

FSA's Response: We agree with this recommendation. FSA staff already uses information obtained through normal contract monitoring channels to inform and refresh volume estimates. Monthly invoice data, for example, is reviewed in detail and used to refine and validate estimates on an ongoing basis. Revisions likely to have a material impact on TIVAS planning will be communicated on an ad hoc basis.

Finding Area: Capacity Planning

Recommendation: FSA should work closely with each TIVAS to understand their specific constraints and understand the required lead time necessary to on-board specific loan and borrower loan volumes.

FSA's Response: The TIVAS contracts are explicitly designed to incentivize selected vendors to assess and plan for maintaining servicing quality and customer satisfaction levels in the face of a wide range of contingencies, including increases in volume. Between the four TIVAS and the multiple not-for-profit servicers currently being implemented, the Department has access to significant excess capacity beyond even the most conservative estimate of upcoming volume for the foreseeable future. Under the competitive, performance-based structure of the TIVAS contracts, each vendor is responsible for ensuring adequate capacity to service their allocation of borrower accounts. If an individual vendor fails to do so, the Department is under no obligation to allocate additional volume and can simply shift accounts to one of the over 20 servicers we expect to have on line over the next three years. It should also be noted that no concerns have been raised with the one-month lead time included in the contracts at present; and as such, FSA believes that the servicers can quickly increase capacity to accommodate an increase of at least one to two million borrower accounts.

Recommendation: FSA should implement a process to actively monitor these constraints at each TIVAS and the appropriateness of the required lead time for on-boarding of loan and borrower volumes.

FSA's Response: As stated previously, the TIVAS contracts are explicitly designed to incentivize selected vendors to assess and plan for maintaining servicing quality and customer satisfaction levels in the face of a wide range of contingencies, including increases in volume. Between the four TIVAS and the multiple not-for-profit servicers currently being implemented, the Department has access to significant excess capacity beyond even the most conservative estimate of upcoming volume for the foreseeable future. Furthermore, no concerns have been raised with the one-month lead time included in the contracts at present. Therefore, FSA believes that servicers can quickly increase capacity to accommodate an increase of at least one to two million borrower accounts.

Finding Area: Contract Requirements

Recommendation: For future on-boarding of servicers, FSA should timely communicate the details of the system and functionality requirements in order to allow for sufficient planning, development and testing by new servicers prior to the implementation phase.

FSA's Response: We agree with this recommendation. In bringing on the new not-for-profit loan servicers, we have established a process under which memoranda of understanding (MOU) are signed with each vendor that clearly outline a schedule of key implementation activities, including the early provision of detailed system and functionality requirements. Meetings are held with the FSA implementation team to review requirements, answer questions, and facilitate the prompt submission and review of validation artifacts.

Recommendation: FSA should document the contract requirements and related clarifications in one location. Contract requirements and clarifications should then be used by FSA for oversight and enforcement of contract terms and conditions.

FSA's Response: We agree with the recommendation. In advance of beginning the ongoing on-boarding process for the not-for-profit loan servicers, FSA staff assembled comprehensive documentation of contract requirements and clarifications. This documentation is updated regularly to reflect new or revised requirements and is used as a reference as appropriate both to review deliverables and validation artifacts and to execute the contract monitoring plan.

Recommendation: For future implementations of servicers, FSA should develop documentation that supports a sustainable on-boarding process. This includes tracking of all clarifications and/or modifications, formal identification of key stakeholders within both TIVAS and FSA, and documented verification of artifact submissions by those business users responsible for various elements of the program.

FSA's Response: As noted previously, FSA has recently developed a sustainable on-boarding process for use in the ongoing implementation of at least 17 not-for-profit loan servicers. This process includes documentation of requirements, establishment of key milestones and stakeholders for each vendor, and centralized documentation of receipt and acceptance of validation artifacts. We will continue to refine this process and accompanying documentation in the future to reflect lessons learned from completed implementations.

Finding Area: Contingency Planning

Recommendation: FSA should implement a process to monitor the contingency planning of each servicer. Monitoring should include capabilities of back up servers and facilities in the event the servicer is required to utilize its non-production environment.

FSA's Response: Each TIVAS is required to comply with applicable security requirements in the contracts, which include back up and disaster recovery requirements. Each servicer's infrastructure and security plan was reviewed and approved by the Department prior to their ability to service federal Direct Loans. The TIVAS contracts were intentionally designed to eliminate the need for excessive process and contingency monitoring, instead relying on competition across multiple vendors to ensure performance. If a servicer were unable to perform due to an unanticipated event, the servicer's borrower account volume can be transferred to another servicer(s) for continued servicing operations.

Recommendation: FSA should evaluate the processes in place at each TIVAS to support the on-boarding of excess borrower volumes in an organized and sustainable manner. FSA's process evaluation should include details on the coordination of specific stakeholders to be notified within FSA and TIVAS in the event of a TIVAS receiving borrower volume in excess of plan and/or capacity.

FSA's Response: As noted in our response to recommendations under Capacity Planning, if an individual vendor is unable to on-board excess borrower volumes in an organized and sustainable manner, the Department is under no obligation to allocate additional volume to that servicer and can simply shift accounts to one of the over 20 servicers we expect to have on line over the next three years. The TIVAS contracts were intentionally designed to eliminate the need for excessive process and contingency monitoring, instead relying on competition across multiple vendors to ensure performance. Therefore, FSA believes that the TIVAS maintain both the incentive and capability to ensure that infrastructure needs are readily scalable in advance of incoming volume, in accordance with the terms of the contracts.

Finding Area: Allocation Methodology

Recommendation: FSA should define minimum and maximum servicing standards to support the goal of improving services to provide better customer service levels. Servicers should be notified of these standards; a monitoring program should be considered to resolve issues before servicers are below the defined minimum standards.

FSA's Response: FSA does not agree that it needs to define minimum servicing standards to support the goal of improving services. Rather than establish a "customer service minimum" that the servicers can satisfactorily meet, FSA established a performance structure that would motivate the servicers to strive for continuous improvement in their customer service performance, and not simply meet a minimum metric. The performance-based approach incentivizes servicers to strive for high-levels of customer service based on the direct impact such performance will have on a servicer's ability to earn additional revenue. Market forces and ongoing competition forces servicers to address a broader range of customer service areas to ensure that borrowers, schools, and FSA are increasingly satisfied with their overall performance, and reduces the government's monitoring responsibilities and costs.

Recommendation: FSA should weight evaluation metrics for future allocations to give greater emphasis to metrics that reflect the long-term goals of the Department and FSA. Survey sample sizes should be defined to achieve representative samples from each distinct population group, which would take into account the varying needs of each customer population.

FSA's Response: FSA does not agree that we should weight evaluation metrics for future allocations. The TIVAS' contracts were designed to meet the needs of the loan programs as well as protect taxpayers' and students' interests, and are directly in line with Federal Student Aid's Strategic Goals for Fiscal Years 2011-2015. Specifically, the following Strategic Goals are directly met by the TIVAS contracts:

Strategic Goal A - "Provide superior service and information to students and borrowers."
By utilizing a true "performance-based" approach to driving performance, the servicers are measured, in part, on their ability to increase customer satisfaction. The "customer" as defined under these agreements include: (1) borrowers; (2) schools; and (3) FSA personnel. This ensures that customer service levels are high and continue to increase.

Strategic Goal C - "Develop efficient processes and effective capabilities that are among the best in the private and public sectors."
The innovative and unique nature of these performance-based agreements allows market forces and the prospect of increased revenue to drive the servicers' performance, and not conventional performance metrics that require excessive government monitoring. As a result, FSA has seen strides towards greater improvement in the areas of default management and customer service, with the servicers making significant investments to increasing performance in both areas.

Strategic Goal D – "Ensure program integrity and safeguard taxpayers' interest."
These TIVAS contracts safeguard the taxpayers' interest in two distinct ways. First, contrary to the commercial loan servicing cost structure, these contracts include a pricing model that incentivizes the servicers to keep borrowers in current repayment and out of delinquency/default, by allowing servicers to invoice higher rates for borrowers in repayment versus increasing levels of delinquency. This ensures that borrowers are kept in good financial standing, while increasing the chances that the government will recoup the funds lent to the borrower for their education. Secondly, these contracts utilize a true "performance-based" approach to driving performance. Instead of using conventional performance measurements or service-level agreements, the servicers are measured on their ability to: (1) keep borrowers out of default; and (2) increase customer satisfaction. This approach ensures that for the servicer to earn additional servicing volume and revenue, only the highest levels of performance will be delivered to the Government for the prices paid.

All sample sizes used provide a statistically valid representation of the overall population of customers measured within the surveys. We periodically review the survey process with the TIVAS and the survey vendor to identify changes to improve the survey process and enhance the precision of the results. FSA will consider changes in the sampling methodology along with other improvements as we continue to work with the TIVAS and the survey vendor to obtain the most reliable information available given constraints related to costs, resources, and customer response rates.