Forward-Looking Information

This section summarizes information pertinent to the Department's future progress and success.

Direct Loan Program

The Department's largest program, the William D. Ford Federal Direct Loan (Direct Loan) program, provides students and their families with funds to help meet postsecondary education costs. Easing the burden of student loan debt is a significant priority for the Department. The following is a discussion of (1) the steps the Department has taken to ensure that student debt is manageable and (2) the risks inherent in estimating the cost of the program.

Managing Student Loan Debt

Each year, federal student loans help millions of Americans obtain a college education—an investment that, on average, has high returns. While the average returns to a college degree remain high, substantial inequities in outcomes exist, and some students leave school poorly equipped to manage their debt, whether due to limited labor market opportunities or high debt.

Traditionally, federal loans of this type have had flat 10-year repayment schedules, making it difficult for borrowers to pay at the start of their career when their salaries are lower. The recent introduction and expansion of the Pay As You Earn (PAYE) and related income-driven repayment plans grant students the opportunity for greater financial flexibility as it pertains to their monthly payment. For more details on these plans, visit FSA's *How to Repay Your Loans Portal*.

As the labor market declined during the financial crisis of 2008, serious challenges in student debt repayment came to the forefront of conversations. The availability of income-driven repayment plans like PAYE and an improving labor market has led to substantial improvement, signifying Departmental progress in the focus area of higher education, namely, its efforts to innovate loan program guidelines in order to make student loan debt more manageable for borrowers across the board. Recent trends in student loan repayment data show that

- More than 80 percent of Direct Loan recipients with loans in repayment are current on their loans.
- Growing numbers of borrowers are taking action and responsibility with regard to their student loans when they are in need of modifications and support. More than five million Direct Loan borrowers have enrolled in PAYE and income-driven repayment options, a substantial increase from the same figure from 2011—an enrollment of 700,000 borrowers.
- Cohort default rates for the most recent cohort of Direct Loan borrowers to enter repayment have declined for the third straight year.

The Department has made progress in this area and continues to work relentlessly to make student debt more manageable. Looking to the future, the Department will build on its recent successes by:

- Conducting significant outreach efforts to inform student loan borrowers of their repayment options, including the protections provided by income-driven repayment plans. The Department has announced a goal of enrolling two million more borrowers in plans like PAYE during the next year.

- Reinventing customer service to ensure that borrowers have access to an affordable repayment plan, high-quality customer service, reliable information, and fair treatment.
- Continuing to support additional tools like the College Scorecard and Financial Aid Shopping Sheet to increase transparency around higher education costs and outcomes, in an effort to help students and families make informed decisions before college enrollment.
- Further protecting student borrowers and taxpayers against predatory practices by postsecondary institutions with recently issued Borrower Defense regulations. These regulations clarify and simplify existing regulations that grant students loan forgiveness if they were defrauded or deceived by an institution of higher education or technical training.
- Launching an experiment to test the effectiveness of new types of, and more frequent, loan counseling for student borrowers. The experiment will test whether requiring additional loan counseling is effective in boosting academic outcomes and helping students manage their debt.

Managing Risks and Uncertainty Facing the Direct Loan Program

Direct Loan program costs are estimated consistent with the terms of the *Federal Credit Reform Act of 1990.* Under the Act, the future costs and revenues associated with a loan are estimated for the entire life of the loan, up to 40 years in this case. The actual performance of a loan cohort tends to deviate from the estimated performance during that time, which is not unexpected given the inherent uncertainty involved in developing estimates. There are three types of risk that make estimating lifetime program costs a difficult task.

Legislative, Regulatory, and Policy Risk

There are inherent risks from the possibility that the cost structure of the Direct Loan program may be altered through legislative, regulatory, or administrative action. In addition, even recent legislative, regulatory, and policy action may be difficult to interpret with regard to effects on financial modeling and estimation, given the lack of actual trend data availability. Some examples of current risks include the following:

Income-Driven Repayment Plans: Several new income-driven repayment plans have been introduced in recent years, including Income-Based Repayment, PAYE, and Revised Pay As You Earn. In general, the proliferation of plans has made income-driven repayment terms more generous and made the plans available to a greater number of borrowers. The Department has also engaged in an outreach campaign to broaden borrower awareness of these plans. These trends have affected recent cost re-estimation significantly through changing the absolute cost of the plans as well as increasing participation in the plans.

Public Service Loan Forgiveness: Enacted in 2007, the Public Service Loan Forgiveness (PSLF) program allows a Direct student loan borrower to have the balance of their Direct student loans forgiven after having made 120 qualifying monthly payments under a qualifying repayment plan, while working full time for a qualifying public service employer (such as government or not-for-profit organization). There is still uncertainty as to how many borrowers will take advantage of the program. Much of this uncertainty arises because borrowers do not need to apply for the program until after having made the 120 qualifying monthly payments. While data on current applications is helpful to gauge potential forgiveness, it may not be representative of final participation figures. In addition, since the first date by which a borrower could receive forgiveness under this program is October 1, 2017, the Department does not yet have a robust set of actual forgiveness data. The available data on borrowers who have already certified their employment, nearly 500,000 borrowers as of September 2016, is less valuable

than it appears since it does not track breaks in their repayment or qualifying employment. The Department continues to remain informed on and manage the risk that may arise in relation to uncertainty about the effect of further borrower outreach on boosting participation in the PSLF program.

Borrower Defense: In May 2015, Corinthian Colleges, Inc. (Corinthian), a publicly traded company operating numerous postsecondary schools that enrolled over 70,000 students at more than 100 campuses nationwide, filed for bankruptcy under deteriorating financial conditions and while subject to multiple state and federal investigations. The Department received thousands of claims for student loan relief from Corinthian students under a provision in the *Higher Education Act of 1965* (HEA) referred to as "borrower defense." In August 2015, the Department initiated a rule-making process to establish a more accessible and consistent borrower defense standard to clarify and streamline the borrower defense process to protect borrowers. Since Corinthian, several other postsecondary schools have closed under similar circumstances, including ITT Technical Institute. The overall financial impact of activity that could lead to valid borrower defense claims, particularly in the for-profit postsecondary sector, coupled with the impact of the recently issued Borrower Defense regulations, is an area of uncertainty. The Department continues to monitor instances of this risk factor to its programs.

Estimation Risk

Actual student loan outcomes may deviate from estimated student loan outcomes, which is not unexpected given the long projection window of 40 years. The complexity of the Direct Loan program, as exemplified by the multitude of available projection paths and possible outcomes, results in inherent uncertainty. For example, estimates that need to be made for loans originating in FY 2016 include how long students will remain in school; what repayment plan will be chosen; whether the loan will be consolidated; whether the borrower will die, become disabled, bankrupt, or have another claim for discharge or forgiveness (closed, borrower defense, etc.); if the loan will go into deferment or forbearance; if the loan will go into default and, if so, what collections will be received on the defaulted loan; and if the loan is in income-driven repayment, what the borrower's employment (public sector or not) and income and family status will be over the next 25 years. These estimates are not only extremely difficult to make but are subject to change if future student behaviors deviate from past experience. Lastly, the Direct student loan portfolio has grown from around $380 billion in FY 2011 to around $960 billion as of the end of FY 2016. This growth naturally results in increased re-estimates, since a re-estimate worth 1 percent of the portfolio today would be more than twice as large as a similar re-estimate in FY 2011 ($9.6 billion vs. $3.8 billion).

Macroeconomic Risk

There is inherent risk due to the long-term nature of the subsidy estimates, as well as the underlying uncertainty in projecting macroeconomic variables many years into the future. Some examples include the following:

Interest Rates: Direct Loan subsidy estimates are very sensitive to changes in interest rates. Recent interest rate history has been anomalous, as interest rates have continued to remain lower than their historical averages. Future interest rate "shocks" could result in actual subsidy costs that deviate from estimated subsidy costs. Under the current program terms, the fixed borrower rates for direct loans are established in advance of the upcoming school year, while the Treasury fixed interest rate on borrowings to fund those loans is not set until after those awards are fully disbursed, which can be as much as 18 months later. Unexpected changes in interest rates during this time can significantly impact the subsidy cost of these loans.

Unemployment: The financial crisis of 2008 and ensuing spike in unemployment rates had a dramatic effect on both student loan volume and student loan performance. Student loan volume peaked along with unemployment, as many displaced workers sought higher education opportunities. Student loan performance suffered as many borrowers repaying their loans were left with much less disposable income with which to make their loan payments. For example, default rates for students in two-year schools, which were at a low of 4.6 percent, for loans entering repayment in 2005, began an upward trend reaching as high as 10.0 percent for loans entering repayment in 2011. While recessions and economic downturns are cyclical phenomena, their exact timing and impact on the subsidy estimates remain an area of uncertainty.

Wage Growth: The estimated costs of income-driven repayment plans are largely dependent on trends in observed wage growth. To the extent that future wage growth deviates significantly from prior wage growth, actual subsidy costs of income-driven repayment plans may deviate from projected subsidy costs. The Department continues to manage risks in this area by continuing to learn about its borrower base and remain informed on such labor market statistics.

Continuous Improvement

Improving critical infrastructure, systems, and overall capacity and ensuring sound strategic decision making regarding allocation of resources are essential to the Department's future progress and success. Exploring the use of shared services and incorporating enterprise risk management are two of the Department's key initiatives.

Shared Services

In alignment with OMB Memorandum M-13-08 and the Office of Financial Innovation and Transformation's Federal Agency Modernization Evaluation framework, the Department and Treasury's Administrative Resource Center (ARC) explored ARC's existing core financial management system and its ability to meet the Department's modernization requirements. During FY 2016, the Department and ARC collaboratively delivered a high-level *Readiness Assessment Report* on migration to ARC's solution set. Beginning in FY 2017, the Department and ARC will restart discussions at a more detailed level regarding the Department using ARC's Shared Service solution set for its core financial system.

Enterprise Risk Management

The Department recently established an Enterprise Risk Management Council. The purpose of the council is to promote effective mission achievement by incorporating enterprise risk management into the basic fabric of how the Department conducts strategic decision making and allocates resources. The council serves as the primary governance structure and coordination point for enterprise-level direction setting with regard to risk management as required by OMB Circular A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control.* In FY 2017, the council will oversee the development of a risk profile and work to increase the consistency and integration of risk management practices across the Department.