

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 pay for their 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 return to a college degree remains 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 expansion of income-driven repayment plans grants 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 Pay As You Earn (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. As of June 2017, nearly 6.3 million Direct Loan recipients were enrolled in income-driven repayment plans, representing a 19 percent increase from June 2016 and a 62 percent increase from June 2015.

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.
- Ensuring 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.

Managing Risks and Uncertainty Facing the Direct Loan Program's Cost Estimates

Direct Loan program costs are estimated consistent with the requirements 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 four 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, 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 more costly to the government) and made the plans available to a greater number of borrowers. Having more plans complicates repayment plan selection, since the tradeoffs between available plans vary by borrower and may not always be entirely clear. Selected comparisons between projected originations and borrower repayments under the different income-driven repayment plans are available on the **Department's website**. The Department has also engaged in outreach campaigns to broaden borrower awareness of these plans. However, future commitment to market and increased participation in these plans are areas of uncertainty.

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 certain types of nonprofit organizations). In general, forgiveness provided via PSLF raises the cost of the Direct Loan program; however, 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 740,000 borrowers as of September 2017, 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, the 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." Valid borrower defense claims would lead to the discharge of borrower debt, thus increasing the cost of the Direct Loan program to taxpayers. However, it is unknown how many of the claims are valid. Since Corinthian, several other postsecondary schools have closed under similar circumstances, including ITT Technical Institute.

In August 2015, the Department initiated a rulemaking process to establish a more accessible and consistent borrower defense standard to clarify and streamline the borrower defense process to protect borrowers. The legality of this rule has since been challenged in court (*California Association of Private Postsecondary Schools v. DeVos*) and certain provisions of the rule have been subsequently delayed. In addition, the Department has initiated a new rulemaking process to consider potential changes to the original rule. The overall level of activity that could lead to valid borrower defense claims, particularly in the for-profit postsecondary sector, coupled with the uncertainty as to the framework of the final rule, make projections as to the financial impact exceedingly difficult. 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 up to 40 years. The Direct Loan program is subject to a large number of future borrower level events and economic factors that heavily impact the ultimate cost of issued loans. For example, estimates that need to be made for loans originating in FY 2017 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 school, 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 types of projections are not only extremely difficult to make but also are subject to change if future student behaviors deviate from past experience. Changes in private student loan markets, such as the recent increase in refinancing of federal student loans into private student loans, also add a layer of uncertainty to student loan estimates. Lastly, the Direct student loan portfolio has grown from around \$380 billion in FY 2011 to around \$1.06 trillion as of the end of FY 2017. 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 (\$10.6 billion vs. \$3.8 billion).

Macroeconomic Risk

The ultimate amount, timing and value of future borrower repayments under the Direct Loan program are heavily affected by certain economic factors, especially since the introduction of income-based repayment plans. 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 atypical, as interest rates have continued to remain lower than their historical averages. 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, the default rate for students was at a high of 14.7 percent for loans entering repayment in 2010, while the most recent rate is 11.5 percent for loans entering repayment in 2014. While recessions and economic downturns are cyclical phenomena, their exact timing and impact on the cost 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 costs of income-driven repayment plans may deviate from projected estimated 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.

Operational Risk

Unforeseen issues in administering and servicing student loans may impact the cost estimates. For example, in March 2017, a tool used to automatically transfer a family's tax information to both student aid applications and income-driven repayment (IDR) plan applications was taken down due to security concerns. Although usage of the tool for IDR recertification has since been brought back up, it is yet uncertain what, if any, impact this outage may have had on student loan cost estimates. However, this example highlights that there is an inherent risk that future, unpredictable disruptions in the administrative status quo may impact student loan cost estimates.

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 expanded use of shared services and incorporating enterprise risk management into Department decision making are two of the Department's key initiatives.

Shared Services

The Department of Education uses shared services where feasible and practical, including payroll and travel. The Department will explore other options to further leverage shared services for other mission support areas in the coming years.

Enterprise Risk Management

The Department plans to implement Enterprise Risk Management (ERM) practices by integrating its existing risk management processes and governance bodies into a suitable ERM framework and including risk as a central element in all critical day-to-day and strategic decision-making activities. The Department will also develop a more risk-aware culture that facilitates increased focus on the wide range of risks the Department faces and fosters more open discussions about how those risks might impact the accomplishment of the Department's mission and whether allocation of resources is aligned to best mitigate risks to an acceptable level. The Senior Management Council will oversee the implementation of ERM in accordance with OMB Circular A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control*.