THE WHITE HOUSE

WASHINGTON

9/23

Mr. President -

As per your request.

Jack

9/24/74

Thanks for your impressions on SR 7.

Digitized from Box C3 of The Presidential Handwriting File
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A

TAB A

How the Default Side of the Program Works

A default legally occurs when a student borrower fails to make a scheduled loan payment for a period of 120 days and the lender attempts collection, then certifies the loan as uncollectable under its terms and conditions. The student borrower must have been out of school for not less than 9 nor more than 12 months before the first payment is due. The efforts of the lender to establish contact with the borrower and to effect collection are covered under the legislated and regulatory areas of "due diligence."

The lender then presents a claim to the government. If the investigation of the claim finds the claim legally sufficient, the claim is paid. The rate at which such claims are paid, that is, the ratio of defaults to loans that are being paid properly (matured paper), has been the subject of controversy.

When a claim is paid, the government has essentially purchased the loan; i.e., the loan is not simply written off. It moves from the collection process of the original lender to that of the Federal Government. The Federal Government can, and does, cause loans for which claims were paid to revert to repayment status. Therefore, the program losses reported are represented not by the rate at which lenders are currently submitting claims, but rather at the rate of true loss--loss rate after the government has made its effort to collect the debt and failed.

DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE
OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20201

September 23, 1974

MEMORANDUM FOR HONORABLE JOHN O. MARSH, JR.
THE WHITE HOUSE

SUBJECT: Defaults in the Guaranteed Student Loan Program

In Secretary Weinberger's absence from Washington, I am responding to your request for information on the large number of defaults in the Guaranteed Student Loan Program. Among the newspaper stories you have read about this problem, you may have noted accounts of Senator Pell's recent hearings on the subject. Those hearings developed into a discussion about the rate of defaults in the part of the program where the Federal government guarantees loans directly. Estimates ranged from 13% to 24% depending upon the assumptions used in the particular projection. In any case, the rate is clearly unacceptable.

The problem does not lend itself to any single solution. The purpose of the program is to provide all students with access to loan financing of educational costs to round out the student aid packages on which students increasingly depend. To this end, the Congress has laid down a scheme under which student loans, subject to certain statutory limits on amount and terms, can be guaranteed either by the Federal government directly or by certain State and non-profit agencies with Federal reinsurance. Some across-the-board approaches to the default problem would run a high risk of disrupting this scheme of providing access to loans, since they would invite discrimination against certain categories of student borrowers.

Fortunately, such a retreat from the objectives of the program is not called for. The great bulk of defaults can be traced to one or another of three factors. Secretary Weinberger has directed that through regulation, tighter administration or relatively minor legislative changes that the Department and the Office of Education deal with these three problem areas:

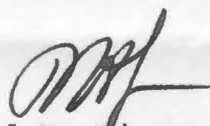
- Inadequate lender practices in the making and servicing of loans. Some lenders have been lax in making sure that the student understands his obligations, in maintaining contact with him to the point where repayments come due and proceeding vigorously to carry out collection efforts. The high proportion of initially defaulted loans on which payments are resumed after mail contact with the student (23 percent in a pilot effort) suggests the extent to which this aspect of the problem is remediable. With the increases in staffing for the program now authorized, we expect to be able to monitor lender practices much more closely and to enforce the sanction of refusing to guarantee loans where such practices are inadequate.

- Abuses of the program by some participating schools. Much of the increase in defaults is attributable to practices of proprietary vocational schools involving high-pressure salesmanship of courses packaged with a Federally guaranteed student loan. A student who finds that the course was misrepresented or that he cannot reasonably expect to benefit from it is then likely to default on his loan. Accordingly, a consumer protection strategy should bring about a major improvement in default rates at the same time that students are provided needed protection. Under regulations about to be published, participating schools would be required to determine the ability of a student to profit from the course and would have to refund unearned tuition. Schools would be subject to special scrutiny if dependent on guaranteed student loan income for so high a proportion of their revenues that the temptation to abuse the program would be strong. Procedures for suspending, imposing conditions on or terminating participation in the program are established by the regulations, including emergency procedures where called for.

- Inadequate collection efforts. Staff resources becoming available to the program will put us in a position to pursue defaulting borrowers much more vigorously. In addition, we have proposed to the Department of Justice that prosecutions be undertaken in selected flagrant

Caution urged here. JM

cases. We are also considering a proposal to exempt student loan indebtedness from relief through bankruptcy proceedings for a period of five years. Action along these lines together with much more effective support of lenders seeking to collect from borrowers before default occurs should have the effect of making it very clear to student borrowers that repayment obligations are neither to be lightly undertaken nor disregarded.



David H. Lissy
Executive Secretary
to the Department

cc:
Honorable James H. Cavanaugh
The White House

THE WHITE HOUSE

WASHINGTON

September 24, 1974

ADMINISTRATIVELY CONFIDENTIAL

MEMORANDUM FOR: KENNETH R. COLE, JR.

FROM: JERRY H. JONES

SUBJECT: Guaranteed Student Loan Defaults

Your memorandum to the President of September 23 on the above subject has been reviewed and the following notation was made:

-- Thanks. Keep pressure on.

cc: Al Haig
Jack Marsh

INFORMATION

THE WHITE HOUSE

WASHINGTON

September 23, 1974

MEMORANDUM FOR THE PRESIDENT

FROM: KEN COLE

SUBJECT: GUARANTEED STUDENT LOAN DEFAULTS

This morning Jack Marsh told me of your desire for additional information on the Guaranteed Student Loan defaults problem.

The Problem

Recent Congressional testimony by U.S. Education Commissioner Ted Bell has generated considerable press coverage due to the large number of defaults on these loans. Some view the problem as approaching scandalous proportions.

The Federal program deals directly with lenders, guarantees 100 percent of losses in 25 states and has full responsibility for collections. In the remaining states the Federal Government reinsures up to 80% of state and private programs. Since 1966 some four million students have borrowed $7 billion under this program. Over one million students each year receive some assistance from the program.

Of $2.6 billion of totally federally insured loans disbursed through FY 74, the net defaults amount to $111.9 million or 12 percent of $952 million dollars of loans matured. For FY 75 the Office of Education anticipates net defaults of $187.6 million against a total loan disbursement of $3.3 billion or 12.7 percent of $1.4 billion matured. $4.4 billion has been loaned through state and private programs with 80% government guarantee. The losses to the government run below the 12% default rate because of more restrictive loan provisions.

The biggest part of the default problem has been with the proprietary, specialized and vocational schools. In FY 74, 39 percent of loan volume and 57 percent of default volume occurred in these areas. Some of these programs sign students up without regard to ability to learn or ability to repay the loan knowing that the student will drop out and default on the loan. A brief description of how the program works is at Tab A.

Corrective Steps

1. During one of your Domestic Council briefings two weeks ago, I mentioned that the Higher Education Act, which authorizes the loan program, will expire on June 30, 1975 and that Jim Cavanaugh was working with Cap Weinberger and others on a paper with recommendations on the extension of this Act. That paper will include recommendations for any legislation changes that are required to tighten up this program. Jim has also been working with Ed McCabe and others at the Student Loan Marketing Association (Sallie Mae) on private sector problems in this area.

2. We believe that the current default rates can be reduced by improved operations at the Office of Education.

   a. In June, a supplemental appropriation authorized additional manpower for OE's efforts to review lender performance.

   b. New regulations authorizing OE to limit, suspend or terminate lenders and schools with poor or illegal practices will be published no later than November 1.

   c. HEW is in the process of reorganizing the administration of the program to tighten up program management.

   d. HEW is developing new information systems to detect earlier potential abuses taking place so that they can be isolated and corrected.