

Prepared for:
U.S. Department of Education
Federal Student Aid
Business Operations

Entity Reviewed:
Pennsylvania Higher Education Assistance Authority
d/b/a FedLoan Servicing
1200 North 7th St
Harrisburg, PA 17102

Prepared by:
U.S. Department of Education
Federal Student Aid
Financial Institution Oversight Service – Eastern Division

Internal Review Report

May 26, 2015

TABLE OF CONTENTS

	<u>Page</u>
A. Review Information	2
B. Entity Information	2
C. Review Objectives.....	4
D. Purpose and Scope of Review.....	4
E. Summary of Element Reviewed.....	4
Element: Servicemember Civil Relief Act	5
Issue 1 – Denial of SCRA Interest Rate Cap Despite a Valid Request	6
F. Conclusion	7

A. Review Information

SID Number: 700579

Program Review Control Number (PRCN): 20144025000

Name and Address:

Pennsylvania Higher Education Assistance Authority
d/b/a FedLoan Servicing
1200 North 7th St
Harrisburg, PA 17102

Dates of Review: August 18, 2014 through August 22, 2014

Review Period: September 10, 2009 through April 30, 2014

B. Entity Information

The Pennsylvania Higher Education Assistance Authority d/b/a FedLoan Servicing (FLS), signed a contract on June 17, 2009, to be a Title IV Additional Servicer (TIVAS) contractor with the U.S. Department of Education (Department) to service Federal Family Education Loan (FFEL) Program loans purchased by the Department from FFEL Program lenders under the Ensuring Continued Access to Student Loans Act of 2008 (ECASLA). Although the Loan Purchase Commitment Program expired September 30, 2010, the Asset-Backed Commercial Paper Conduit Put Program allowed FFEL Program lenders to sell loans to the Department until January 19, 2014. In 2010, the TIVAS contract was extended to include servicing of the William D. Ford Direct Loan (Direct Loan) Program, as well as FFEL Program loans owned by the Department. The FFEL and Direct Loan programs are authorized by Title IV of the Higher Education Act of 1965, as amended (HEA).

Background

The Servicemembers Civil Relief Act (SCRA) provides a wide range of protections for individuals entering or called to active duty in the military or servicemembers already deployed. In regard to FFEL loans and Direct Loans, the SCRA limits the interest rate a borrower may be charged on a loan made to the servicemember entering qualifying military service to six percent. When the servicemember ends a period of active duty military service, the interest rate should return to the original rate. The six percent interest rate applies during any period when the borrower is on active duty military service.

The SCRA's interest rate limit first became applicable to the FFEL and Direct Loan programs with the passage of the August 14, 2008, Higher Education Opportunity Act (HEOA) which amended §428(d) and 438 of the HEA to incorporate the SCRA's interest rate limitation.

The Department's Dear Colleague Letter (DCL) GEN-08-12/FP-08-10 issued December 2008 included guidance to FFEL loan holders regarding the application of the SCRA for FFEL

Program and Direct Loan Program loans.¹ Page 120 of the DCL noted that the interest rate limitation applied to borrowers in active duty military service as of August 14, 2008, but did not apply to an endorser of a PLUS loan unless that borrower is also performing eligible active duty military service. The DCL also stated that:

...Under the SCRA, the borrower must contact the creditor (loan holder) in writing to request the interest rate adjustment and provide a copy of the borrower's military orders. For this purpose, the term "in writing" may include a borrower's email request and the term "copy of the borrowers' military orders" includes a scanned copy of the orders attached to that email request.... The Department will apply the SCRA interest rate limit to Direct Loan borrowers in the same manner.

On October 29, 2009, the Department published final regulations in the Federal Register that included changes to implement the SCRA interest rate cap. The regulations became effective July 1, 2010. The final regulations added 34 CFR §682.202(a)(8) which provides:

The charges that lenders may impose on borrowers, either directly or indirectly are limited to the following:

(a) Interest. The applicable interest rates for FFEL Program loans are given in paragraphs (a)(1) through (a)(4) and (a)(8) of this section.

(8) Applicability of the Servicemembers Civil Relief Act (50 U.S.C.527, App. sec. 207). Notwithstanding paragraphs (a)(1) through (a)(4) of this section, effective August 14, 2008, upon the loan holder's receipt of the borrower's written request and a copy of the borrower's military orders, the maximum interest rate, as defined in 50 U.S.C. 527, App. section 207(d), on FFEL Program loans made prior to the borrower entering active duty status is 6 percent while the borrower is on active duty military service.

The final regulations also changed the Direct Loan Program regulations at 34 CFR §685.202(a)(4), to similarly provide:

(4) Applicability of the Servicemembers Civil Relief Act (50 U.S.C. 527, App. sec. 207). Notwithstanding paragraphs (a)(1) through (3) of this section, effective August 14, 2008, upon the Secretary's receipt of a borrower's written request and a copy of the borrower's military orders, the maximum interest rate, as defined in 50 U.S.C. 527, App. section 207(d), on Direct Loan Program loans made prior to the borrower entering active duty status is 6 percent while the borrower is on active duty military service.

¹ Section C.1.4.3 (Constraints) of PHEAA's TIVAS contract states that "[t]he contractor(s) will be responsible for maintaining a full understanding of all federal and state laws and regulations and FSA requirements and ensuring that all aspects of the service continue to remain in compliance as changes occur." The Department's DCL system provides FSA program direction and compliance guidance.

On December 12, 2013, FSA issued Change Request (CR) 2278 which states that “FSA needs to ensure that active duty personnel are receiving the active duty student loan benefits they are entitled to receive.” This CR instructs all of FSA’s servicers to “...do a match with the Department of Defense (DoD) database to identify active duty military personnel for purposes of applying active duty military benefits to eligible loan recipients.” On April 7, 2014, FSA issued CR 2409 which states that the “[t]he servicers shall outreach to all eligible active duty personnel identified in the DoD match (per CR 2278) and ongoing annually....The servicers should track the results of this outreach activity and report to FSA any problems or successes with this effort.” On May 19, 2014, CR 2658 instructed the TIVAS to use the Defense Manpower Data Collection (DMDC) database to “...replace the requirement for the receipt of orders...as long as the servicer notifies the service member that the benefit is being applied and provides the service member an opportunity to request additional information.” FLS has implemented CR 2658 which is expected to address the issue identified in this report.

C. Review Objectives

The objective of this review was to determine whether eligible borrowers of eligible FFEL loans and Direct Loans received the benefit of the 6 percent interest rate cap provided by the SCRA in accordance with applicable statutes and the Department’s regulations and guidance.

D. Purpose and Scope of Review

The purpose of this review was to:

- (1) Determine whether FLS complied with all Departmental statutes, regulations, and guidance in determining whether a borrower was eligible to receive the interest rate cap provided by the SCRA, and
- (2) Ensure that eligible borrowers who met the requirements for the interest rate cap under the SCRA were granted the benefit on all their eligible federal student loans.

Financial Institution Oversight Service (FIOS) conducted a program review at FLS from August 18, 2014, through August 22, 2014. The review covered the period September 10, 2009, through April 30, 2014. The review was limited to loans owned by the Department and serviced by FLS under the TIVAS contract. The review did not cover whether FLS applied the SCRA interest rate cap correctly on FFEL loans it held and loans it serviced for other holders or private student loans.

E. Summary of Element Reviewed

Using the National Student Loan Data System (NSLDS), FIOS extracted a population of 29,102 FFEL Program loans and Direct Loans owned by the Department with an interest rate in excess of 6 percent that had been granted either a military deferment or a military grace period between September 10, 2009, the date FLS began servicing loans for the Department, and April 30, 2014, and were serviced by FLS under the TIVAS contract. A statistically valid random sample of 99

loans, representing 99 distinct borrowers, was selected for testing from the population of 29,102 loans. FIOS used its standard expected deviation rate of 0.0 percent, tolerable deviation rate of 3 percent, and confidence level rate of 95 percent, based on the population of 29,102 records, to arrive at the sample size of 99, as defined by IDEA data analysis software.

Element: Servicemember Civil Relief Act

Borrowers in active duty military service may have the interest rate charged on FFEL Program and Direct Loan Program loans limited to 6 percent. Under the Department's regulations, to receive the benefit of the interest rate cap under the SCRA during the period covered by the review², the borrower must have provided the servicer with a written request for the benefit and a copy of the appropriate military orders. These documents may be provided in paper form or by email. In some cases, a representative with the borrower's power of attorney may present the documents on behalf of the borrower. The servicer must grant the benefit based on the military orders provided and may use information obtained through the Defense Manpower Data Collection (DMDC) system to augment the information in the request.

Methodology:

FIOS interviewed key FLS officials responsible for servicing loans under the TIVAS contract, including the company's Vice President FLS Operations, Deputy General Counsel, Manager of Compliance, Manager of FLS Program, Continuous Improvement Analyst, Production Support Analyst, and Supervisors of Client Contractual Testing. FIOS reviewed FLS's processes and procedures to ensure that they adhered to the requirements in the HEOA and the Department's regulations, and other guidance in regard to SCRA. To determine active duty military service dates and SCRA eligibility, data from NSLDS, FLS's internal system, and borrower records were reviewed and any inconsistencies were reconciled. For all loans in the sample, copies of monetary transaction histories, collection activity histories, and deferment histories were also reviewed.

All samples were tested to determine whether FLS:

- Notified the borrower that they may be eligible for the SCRA interest rate cap,
- Granted the SCRA interest rate cap when the borrower requested the benefit in writing and submitted a copy of their military orders, and applied the interest rate cap to all eligible loans, both FFEL Program and Direct Loan Program loans,
- Denied the SCRA interest rate cap in accordance with the Department guidelines,
- Granted the interest rate cap for the correct time period for borrowers approved for the SCRA interest rate cap, and
- Adjusted the SCRA interest rate cap back to the original interest rate if the borrower left active duty military service or was otherwise found to be ineligible for the SCRA interest rate cap.

² Since the period covered by the review, the Department has changed the process for insuring that eligible borrowers receive the benefit of the interest rate cap under the SCRA.

Results:

For the 99 borrowers tested:

- FLS notified 30 borrowers of their potential eligibility. Notifying the borrower of their potential SCRA eligibility was not required during the period covered by the review.
- 8 borrowers requested the SCRA interest rate cap:
 - FLS granted the SCRA interest rate cap to 6 borrowers:
 - FLS correctly granted the benefit to 6 borrowers.
 - FLS incorrectly granted the benefit to 0 borrowers.
 - FLS denied the SCRA interest rate cap to 2 borrowers:
 - FLS correctly denied the benefit to 1 borrower.
 - FLS incorrectly denied the benefit to 1 borrower.
 - FLS used the correct active duty military service dates to determine the benefit period for all 6 borrowers granted the benefit.
 - FLS correctly adjusted the interest rate cap back to the original interest rate for all 6 borrowers granted the benefit.

There was one issue identified.

FIOS found that FLS did not fully comply with all Department statutes, regulations, and guidance for granting the interest rate cap provided by the SCRA to eligible servicemembers. Specifically, FLS denied the SCRA interest rate cap to one eligible borrower despite the borrower's valid request.

Issue 1 – Denial of SCRA Interest Rate Cap Despite a Valid Request

FLS failed to process a valid SCRA interest rate cap request for one eligible borrower where the borrower had requested the benefit from a prior servicer.

FLS provided the Department with documentation indicating that the borrower requested the SCRA benefit from the prior servicer. Although the request was documented in the file and known to FLS, FLS failed to properly respond to the borrower's request. FLS stated that it did not begin servicing the loan until March 29, 2013, and that, "therefore, a copy of any communication sent to the borrower regarding SCRA benefits would have been sent by the prior servicer and is not available to FLS." The change of servicer should not have prevented a borrower from receiving proper loan servicing which included granting the SCRA interest rate cap reduction once the borrower's request was known.

Recommendations:

We recommend that the Business Operations direct FLS to —

- 1.1 Retroactively grant the SCRA interest rate cap to the eligible borrower and adjust the borrower's account accordingly.

- 1.2 Develop and implement a procedure to require that servicers correct account servicing errors regardless of servicer assignment date.

F. Conclusion

The program review identified the following issue:

- FLS failed to process a valid SCRA interest rate cap request for one eligible borrower where the borrower had requested the benefit from the prior servicer. Although the request was documented in the file and known to FLS, FLS failed to properly respond to the borrower's request.