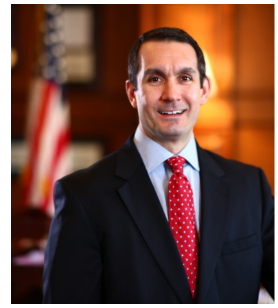
EMPOWERING COLLEGE BORROWERS

More Tools Needed to Navigate Complex System

A special report on the PA Higher Education Assistance Agency
by Pennsylvania Auditor General Eugene A. DePasquale

DEAR FELLOW PENNSYLVANIANS,



When I announced this follow-up special report to the Pennsylvania Higher Education Assistance Agency (PHEAA)'s 2008 audit, no one could have anticipated that existing issues with paying for higher education would be elevated by a worldwide public health crisis.

Prior to the pandemic, Pennsylvania residents had an estimated $68 billion in student loan debt and an average total of $37,061 per borrower, the second-highest amount of student loan debt in the nation. The COVID-19 pandemic has not only changed how students attend class, but has also made successfully navigating the already-complex financial aid process even more vital for students and their families.

This special report examines not only how PHEAA has evolved since the last audit, but also how we as a commonwealth can help students acquire higher education while not being driven into dire financial straits for decades.

In 2008, this department's special performance audit of PHEAA uncovered many ethically and fiscally irresponsible issues regarding how the state-related entity was failing students on their path to acquiring higher education. Among these issues were findings that PHEAA executives were spending lavish amounts to award executives millions of dollars in bonuses, to take expensive travel trips to luxury resorts, and to create and promote excessive promotional and advertising materials. All of this was made possible by a culture that awarded those at the top instead of devoting taxpayer-funded resources to help Pennsylvania's vulnerable, and promising, students.

This follow-up special report shows encouraging signs that PHEAA has implemented many of the 2008 recommendations and that the culture of self-reward is being revamped to better serve our students. While the overall observation still stands — the PHEAA board needs to be diversified to bring in members from various other sectors — PHEAA has made great improvements in other areas. These areas include better fiscal management of PHEAA's travel and vehicle usage, curtailing excessive employee compensation and incentives, and becoming more diligent and systematic with regard to contracts, vendors and advertising. While not legally obligated to do so, PHEAA now follows policies that are more closely aligned with commonwealth practices, which helps hold the agency more accountable to taxpayers and students. The financial impact of these changes is significant; in the first two years alone, PHEAA reports these reforms saved $74 million to reinvest in Pennsylvania students.

However, in the midst of a pandemic, which has only made issues in the student loan industry more prominent, there is more work to be done. Students need more resources to help them make sound financial decisions. Prior to the pandemic, unprecedented increases in tuition and widespread student loan debt were gaining national attention. Because of their heavy loan burdens, some students were forced to drop out of college or risk going into greater financial distress. Combine these facts with loan servicers being repeatedly sued for leading borrowers down the wrong path, student confusion surrounding popular repayment options, and for-profit colleges closing while nonprofit colleges face an uncertain future, and it all creates serious questions regarding the future of higher education and who can actually afford it.

That is why this report also calls for the creation of an independent Office of Student Loan Advocate or Ombudsman. An advocate could help students navigate the complex and incredibly important decisions about financing higher education. While some students have the assistance of knowledgeable parents, many students are navigating these life-changing decisions on their own. Since 2017, 10 other states have created such an office, and the central tenet of their mission is to improve the outcomes for student loan borrowers in their states.

This report also makes two other recommendations to improve the student loan landscape in Pennsylvania — one for PHEAA and one for the General Assembly.

Thank you for the opportunity to serve you.

Sincerely,

Eugene A. DePasquale

GLOSSARY

FEDLOAN SERVICING (FLS) is a PHEAA loan-servicing operation that collects payments from borrowers of federally held student loans.

AMERICAN EDUCATION SERVICES (AES) is a PHEAA loan-servicing operation that collects payments from borrowers of commercial and private student loans.

LOAN SERVICERS are companies that collect payments on a loan from dispersal to repayment.

PUBLIC SERVICE LOAN FORGIVENESS (PSLF) is a program that forgives the remaining balance on federal loans received from the William D. Ford Federal Direct Loan (Direct Loan) Program. Such borrowers must work full-time and make 120 monthly payments under a repayment plan — and the borrower’s employer, payments and repayment plan must all meet specific qualifications.

LOAN FORGIVENESS is a relinquishment of the borrower’s obligation to pay the balance of their federal student loans.

LOAN FORBEARANCE is a temporary suspension of student loan payments. During forbearance, the loan continues to accrue interest but borrowers are not penalized for nonpayment.

PRIVATE STUDENT LOANS are made by private organizations such as banks, which set their own terms and conditions for repayment and interest accrual.

FEDERAL STUDENT LOANS are made by the federal government and are regulated by federal laws.

SUBSIDIZED LOANS are loans for which the lender, usually the federal government, pays the interest during specific periods.

UNSUBSIDIZED LOANS are loans for which the borrower must pay all accrued interest.

FREE APPLICATION FOR FEDERAL STUDENT AID (FAFSA) is a form created and processed by the Office of Federal Student Aid within the U.S. Department of Education. The FAFSA evaluates the eligibility of qualifying students for federal financial aid including grants, loans and work study.

LOAN DEFERMENT is a temporary suspension of student loan payments. The loan stops accruing interest, and borrowers are not penalized for nonpayment.

INCOME-BASED REPAYMENT PLANS adjust qualifying borrowers’ federal student loan repayment amounts to a certain percentage of their discretionary income.

ED (U.S. DEPARTMENT OF EDUCATION) is the executive-level department of the U.S. government that oversees the Office of Federal Student Aid, which provides federal student loans serviced by operations such as FLS and AES.

HISTORY OF PHEAA

The history of the Pennsylvania Higher Education Assistance Agency (PHEAA) over more than 50 years is one marked with periods of significant growth and evolution as it continually adapts to the changing world of student aid. As its scope of work changes, its legal status as it relates to the Commonwealth of Pennsylvania has become more complex and legally challenged.

1963-2007: Evolving into a full-service student loan agency

PHEAA was established by the Pennsylvania General Assembly through Act 290 of 1963. That same year, state voters approved a referendum that amended the state constitution to authorize PHEAA to provide grants or loans for commonwealth residents for higher educational purposes for the first time, including serving as a guarantor of federal loans. Over the next 20 years, the General Assembly greatly expanded PHEAA's functions as follows:

- **GRANT AND SCHOLARSHIP ADMINISTRATION.** Act 541 of 1966 tasked PHEAA with awarding grants through the PA State Grant Program.[1]
- **LOAN SERVICER.** Act 357 of 1974 authorized PHEAA to service loans, leading PHEAA to become a servicer for national lenders in 1975. This includes payment processing, customer service, and collector activities.[2]
- **LENDER.** Act 330 of 1982 allowed PHEAA to begin to raise money by selling bonds to fund its own student loans.[3]

[1] 24 P.S. § 5151 *et seq*. More specifically, 24 P.S. §§ 5151-52. (i.e., State Scholarship Program).
[2] 24 P.S. § 5104(1.1).
[3] 24 P.S. § 5104(3).

2008-2012: Financial Crisis Reshapes Functions

Amid the focus on unemployment, foreclosures and dissolution of “too big to fail” banks, the federal government’s massive student loan bailout received scant attention during the Great Recession. When funds for student loans at banks dried up with no ability to issue new loans, the U.S. Department of Education (ED) in 2008 bought $110 billion in loans from private lenders. In 2010, the federal government overhauled the student loan system by replacing the bank-based loan system with a greatly expanded Direct Loan (DL) program, with students borrowing directly from ED. With purported concern about its ability to assume the servicing of such an enormous number of loans, “all new loans will be direct loans delivered and collected by private companies under performance-based contracts with the Department of Education.”[4]

This dramatic overhaul of the student loan industry served as a major turning point for PHEAA. With its loan-originating business vastly reduced, it became one of four large firms to contract with ED to service the new federally owned loans by the U.S. Treasury. PHEAA operates these loan servicing entities under two names: FedLoan Servicing (FLS) and American Education Services (AES). The federal government pays FLS on a per-loan service basis. AES is paid by the commercial banks for loans it services. PHEAA processes payments and provides customer service for borrowers until the loan has been repaid. PHEAA services more than $454 billion in student loans, which is around 20 percent of the nation’s student debt.[5]

2013-Present: Declining Operating Income Leads to More Changes

The federal government’s shift away from commercial lending and toward servicing did not leave PHEAA flush with funds. Instead, it experienced a steady and dramatic decline in net operating income, from $222 million in 2014 to $21.5 million in 2018.[6]

In September 2020, PHEAA officials cited three factors contributing to the decline:

- **COSTLY REGULATORY CHANGES.** In particular, increased federal and state monitoring and oversight, as well as numerous lawsuits.
- **COMPLEX CHANGES TO PROGRAMS WITH NO SIGNIFICANT INCREASE IN FEES PAID TO PHEAA.** As an example of program changes that result in increased costs, it cites the servicing of 35 different Income Driven Repayment (IDR) Plans: “The requirements for these plans are confusing to customers and result in incorrect form submission or lack proper documentation to process the form and result in additional customer support needed to properly place customers into the appropriate IDR plan.” Other costly changes in program complexity cited by PHEAA include the Public Service Loan Forgiveness (PSLF) Program, changes to security protocols, investment in technology, inaccurate estimates from the federal government about work volume, and a disruptive procurement process.

[4] https://obamawhitehouse.archives.gov/issues/education/higher-education/ensuring-that-student-loans-are- affordable
[5] This is according to the complaint filed by the New York Attorney General in *People of the State of New York v. PHEAA, d/b/a FedLoan and American Education Services*, U.S. District for the Southern District of New York, Case No. 19-cv-9155, filed October 3, 2019, page 6. (Please note that this matter is currently in discovery as ordered by a federal district judge on May 20, 2020.)
[6] https://www.inquirer.com/business/fedloan-student-loans-lending-pheaa-pennsylvania-higher-education- assistance-agency-james-steeley-20190224.html

- **INCREASED EMPLOYEE COSTS.** PHEAA employees are covered under the union contract negotiated by the Commonwealth and, between 2009 and 2020, have experienced dramatic increases in retiree (91%) and healthcare (37%) costs.

After several years of declining net operating income and continually increasing tuition in higher education, PHEAA in 2018 developed a new strategic plan to put it on a more solid financial path including a new financial aid option provided to families and aiming to improve customer service. As part of this new plan, it returned to its role as a loan originator. Funded by an initial pledge of $50 million in bonds provided by Gov. Tom Wolf through the Pennsylvania Department of Community and Economic Development and a line of credit from Treasurer Joseph Torsella, in 2019 it created a new private student loan called the PA Forward Student Loan Program. Eligibility for such a loan is limited to Pennsylvania undergraduate students, graduate students, and parents, as well as borrowers from a handful of approved states contiguous to PA who attend PA schools. The program also offers a refinancing loan for student loan borrowers looking to consolidate private and federal loans from the same handful of approved states.[7] Any net revenues from the PA Student Loan Program will go to further PHEAA's public service mission.

PHEAA touts many benefits of the PA Forward Student Loan Program, including a low guaranteed fixed interest rate, no application or origination fees, and a range of borrowing options from $1,500 to full tuition costs. At launch, it offered a fixed rate as low as 4.7%, lower than the average private student loan rate (8.85%). PHEAA says that it capitalized on the national economic trends in March 2020 and reduced the fixed rate for new applications and already-booked loans by 98%. In addition, Gov. Wolf and Treasurer Torsella dedicated $2.2 million in CARES Act funding to apply a zero percent interest rate and forbearance on the loans from March 13 to Sept. 30, 2020.

PHEAA says that through its financial literacy events, it educates borrowers to first utilize the federal Stafford undergraduate loans, with significantly lower interest rates, before taking a private loan, including the PA Forward Student Loan.

In fiscal year 2019, the PA Forward Student Loan Program issued 3,100 student loans totaling $41.2 million; in 2020, the loan program was expected to disburse $75 million before the COVID-19 pandemic, with the revised estimation now between $48 million and $58 million.[8]

High-Profile Challenges with Servicing, PSLF Program

PHEAA has been the target of criticism for allegations of general performance issues with borrowers as well as specifically mishandling the servicing of the Public Services Loan Forgiveness Program (PSLF).

PHEAA was cited by a 2019 federal audit for having service problems. A 2017 study cited PHEAA as having among the worst "failure rates" (not sufficiently informing borrowers of all options) of all loan servicers.[9]

[7] https://www.meadvilletribune.com/news/pheaa-launches-new-student-loan-refinance-option/article_7d71aed2- 469e-11ea-817d-27b04fdfde93.html
[8] Pennsylvania House Appropriations Hearing for James Steeley, President/CEO of PHEAA on March 2, 2020.
[9] https://www2.ed.gov/about/offices/list/oig/auditreports/fy2019/a05q0008.pdf

As part of its 2017 strategic plan, PHEAA pledged to improve its customer service. Recent data suggests some improvement: In a federal government ranking of loan service providers on a variety of metrics, including customer service, PHEAA moved from a ranking of eighth to fourth out of nine providers.

A closer look at the PSLF issue reveals a more complicated situation marred with serious errors and poor communication from the federal government coupled with servicing problems by PHEAA.

Established by Congress in 2007, the PSLF Program encouraged people to enter careers in public service and teaching by offering forgiveness for remaining federal student loan balances for those in eligible careers who make 120 on-time monthly payments (10 years). This program was highly touted by the members of Congress who passed the law and by employers seeking to attract employees. Although PSLF was created in 2007, ED did not promulgate formal regulations surrounding PSLF until 2012 — five years later.

The programs were popular: Over 1 million borrowers initiated participation by April 2018. PHEAA became the exclusive contractor for servicing the federal program in 2013.

Problems with the PSLF Program began to surface in 2017, as their first wave of borrowers began to apply for loan forgiveness. A shocking 99 percent of those who applied were rejected. Thus tens of thousands of borrowers who anticipated having their loans canceled were told they wouldn't get any help. Most of the rejections were due to confusion about what ED says qualifies as an eligible payment or repayment plan, with some borrowers claiming they received no warning or guidance from the servicer (PHEAA) about a potential problem, and in some cases receiving assurances that they were on track.[10]

A September 2018 study by the Government Accountability Office (GAO) — an independent, nonpartisan federal agency known as the "congressional watchdog" — accuses ED of failing to provide "key information to the PSLF servicer [PHEAA] and borrowers" as well as not ensuring that "the PSLF servicer [PHEAA] is receiving consistent loan payment history information from other loan services, increasing the risk of inaccurate qualifying payment counts."[11] The study tasks PHEAA with improving its performance in several areas, such as giving borrowers more information about which payments qualified.

The remarkable 99 percent rejection rate created a bevy of news stories and criticism from consumer advocates, with PHEAA receiving a great deal of the heat. The attorneys general of Massachusetts and New York are suing PHEAA for its alleged failures in servicing the federal student loans in the PSLF program.[12] Despite being a target of blame, PHEAA extended its contract with ED to service the loan program for another two years (through 2021). The new contract did not change any pricing but did secure pledges from ED to make improvements to reform the program so that borrowers are better informed about qualification. PHEAA President James Steeley has said he is optimistic that fewer people will be denied in the future due to the changes in the program.[13,14]

[10] https://www.npr.org/2018/10/17/653853227/the-student-loan-whistleblower
[11] https://www.gao.gov/assets/700/694304.pdf
[12] https://www.nytimes.com/2019/10/03/business/student-loans-forgiveness-pheaa.html
[13] https://www.penncapital-star.com/criminal-justice/with-their-contract-extended-pheaa-officials-suggest- improvements-to-controversial-federal-student-loan-program/
[14] https://www.pahouse.com/files/BudgetHearingTestimony/2020-21/04-13/2020_0033THighEdAssAgcy.pdf

Legal Status of PHEAA[15]

Various courts have been asked on multiple occasions to determine if PHEAA is a private entity, a federal entity, a multistate entity or a Pennsylvania municipal entity. Such questions are bound to arise given that PHEAA is critical to the national and state higher education student financial aid arena for student loans and grants, as well as being a federal loan servicer.

PHEAA consistently argues in federal court that it is an arm of the state government. While the federal courts have at times not upheld that argument depending on the matter at issue,[16] they have recognized PHEAA's status as a state entity with state statutory protections. In fact, most recently in 2019, the U.S. Fourth Circuit Court acknowledged that PHEAA is a "state created agency" and that it was "intended to facilitate issuance of federal student loans."[17]

As noted earlier, PHEAA is being sued by the Massachusetts and New York attorneys general. Both of these ongoing cases center on accusations that PHEAA failed PSLF program participants and should be held liable for borrowers' inability to receive loan forgiveness.

Given that PHEAA is considered a government entity under state law, fear exists that such lawsuits could lead to the commonwealth being on the hook for damages from a successful suit. Fortunately, the Pennsylvania General Assembly has:

- limited the commonwealth's liabilities, thereby insulating the commonwealth from PHEAA's debts;
- limited PHEAA's power to pledge the credit/ taxing power of the commonwealth[18] and has not pledged to, covenant and agree to cover the holders of any bonds, notes or other obligations[19]; and
- provided for a hold-harmless provision ensuring that all property/moneys of the agency will revert back to the commonwealth in the event of PHEAA's dissolution.[20]

[15] Important disclaimer: Federal law and Pennsylvania law must be distinguished from each other and each legal issue must be considered as separate and distinct as to the status of PHEAA. The Supreme Court of Pennsylvania has determined that an entity's status as an agency or instrumentality **varies**, depending on the issue for which the determination is being made. See *Pennsylvania State University v. Derry Tp. School Dist.*, 557 Pa. 91, 96, 731 A.2d 1272, 1274 (1999) (emphasis added). This also holds true for a federal court's determination of the nature of a government entity and its relationship with the state and the issue to be determined (e.g., liability and/or defense under the False Claims Act *et seq.,* 31 U.S.C. § 3729; the Fair Credit Reporting Act, 15 U.S.C. § 1681 *et seq.*; and the Fair Labor Standards Act, 29 U.S.C. § 201 *et seq.*).

[16] *Pele v. Pa. Higher Educ. Assistance Agency*, 628 Fed.Appx. 870, 872 (4th Cir, 2015), cert. denied, 137 S. Ct. 617 (2017) (not entitled to sovereign immunity under the Fair Credit Reporting Act) (please note that this is an unpublished opinion that is not binding on the Circuit); *United States ex rel. Oberg v. Pa. Higher Educ. Assistance Agency et al.,* 804 F.3d 646 (4th Cir. 2015) (not entitled to sovereign immunity under the under the False Claims Act).

[17] See *United States ex rel. Oberg v. Pa. Higher Educ. Assistance Agency et al.,* 912 F.3d 731 (4th. Cir. 2019).

[18] There is "no obligation of [PHEAA that] shall be a debt of the State/Commonwealth and it shall have no power to pledge the credit or taxing power of the State/Commonwealth nor/or to make its debts payable out of any moneys except those of the corporation." See Subsection (3) and (8) of 24 P.S. § 5104 (relating to Powers and Duties).

[19] 24 P.S. § 5105.7 (relating to Covenant by Commonwealth not to limit or alter powers vested in agency).

[20] 24 P.S. § 5109 (relating to Dissolution).

OVERALL OBSERVATION:
THE PENNSYLVANIA GENERAL ASSEMBLY HAS FAILED TO IMPLEMENT SERIOUS REFORM TO RESTRUCTURE PHEAA'S BOARD OF DIRECTORS, DECREASE THE NUMBER OF LEGISLATORS, AND ADD DIVERSE MEMBERS FROM EDUCATION, FINANCE AND OTHER FIELDS IN THE PRIVATE SECTOR.

The 2008 PHEAA special performance audit's overall conclusion was that the PHEAA's Board of Directors (board) was inappropriately composed largely of legislators. The department recommended that PHEAA have a more diverse board of professionals from the fields of education and finance that would provide not only a multifaceted perspective, but also a checks-and-balance system. Having such a more balanced board would keep PHEAA more accountable to the students it serves.

Approximately 12 years later, PHEAA remains governed by a 20-member board of directors, with 80 percent of those directors being legislators. The board make-up is as follows:

- 16 state legislators
- 3 members appointed by the governor
- The Pennsylvania Secretary of Education[21]

In 2010, the Pennsylvania General Assembly attempted to institute some changes to the board when the members repealed the board composition portion of the PHEAA Act.[22] Under this substitute provision in the Administrative Code, unless an existing legislative board member wants to be reappointed, it allows the legislative leader to fill their seat with a non-legislative individual of the leader's choice from the private sector at the end of the legislative board member's term.[23]

Essentially, when a legislator's term on the board expires, the legislator has the option of allowing a non-legislative individual to become a replacement by the legislative leader provided they have relevant experience in the fields of finance, banking, investment, information technology, higher education, or higher education finance. A legislator is clearly eligible to be nominated by the governor after their term expires to resume their seat on the board. The reality is that, since 2010, legislative members have continually wished to be reappointed, resulting in a seamless transition from one legislative member to another with no replacement by a non-legislative individual.

Despite this legislative change 10 years ago, the board's composition has remained essentially the same, with 16 members being legislators.

In 2008 and today, no other state has public boards composed so heavily of legislators or state-related members with such a small percentage of private sector board members. Pennsylvania is an outlier among most other states which largely have boards that are composed of voting members from diverse sectors of state legislatures, finance, education, banking, students and other areas of the private sector.

[21] The Secretary of Education serves by virtue of his/her office (i.e., ex-officio member) and is a voting member of the PHEAA board.
[22] 71 P.S. § 111.2 (Adm. Code § 401.2), Act 50 of 2010, enacted July 9, 2010 (in the Administrative Code of 1929).
[23] Specifically, 71 P.S. § 111.2(b)(1).

OVERALL OBSERVATION (CONT.)

The Pennsylvania General Assembly fell short in its efforts to act on the department's overall 2008 recommendation to restructure the PHEAA board to include fewer legislators and instead to pull together a group of individuals with the technical expertise necessary to improve how students pay for their education. The 2010 legislative provision enacted after the 2008 audit report was too non-mandatory to provide for a meaningful change to the board.

Diversity on the board would not only expand the board's professional base, but would also provide much stronger oversight. As a result, there would be greater public confidence that PHEAA is meeting its core mission — to create access to higher education and to improve educational opportunities for Pennsylvanians.

The General Assembly should promptly amend the related 2010 Administrative Code provision to allow for a more diverse PHEAA board with mandatory board composition requirements.

2008 OVERALL FINDING	PHEAA's governing board must be restructured to include more diversity — specifically, members from the fields of higher education and finance — who will make tough decisions to keep the agency focused on its mission.
2008 RECOMMENDATION	To ensure that PHEAA is governed to achieve the goals of accountability, exemplary leadership, and transparency, and based on the overall conclusion drawn from our audit findings, we call on the General Assembly to act immediately to restructure and diversify PHEAA's board of directors.

OBSERVATION 1:
PHEAA HAS IMPLEMENTED THE 2008 AUDIT RECOMMENDATIONS WITH REGARD TO BETTER FISCAL MANAGEMENT OF ITS VEHICLE USAGE AND TRAVEL POLICY, BRINGING THEM MORE IN LINE WITH OTHER STATE AGENCIES.

The department's 2008 special performance audit found significant issues with PHEAA's vehicle use and travel policy procedures. Since 2008, PHEAA has implemented the department's recommendations and has brought these policies more closely in line with commonwealth policies.

PHEAA's previous vehicle policy allowed spouses of PHEAA employees to use vehicles, which is counter to commonwealth policies that prohibit non-employees from using state-issued vehicles at taxpayers' expense. These previous policies also allowed PHEAA employees to use the state-provided and taxpayer-funded vehicles for personal use without providing proper documentation of vehicle expenses.

In PHEAA's follow-up response for this report, it was clear that PHEAA has implemented the department's 2008 recommendations, including reducing the vehicle fleet, updating the vehicle use policy to prohibit personal use and use by non-employees, and using a standardized form to properly track vehicle expenses across the agency.

2008 FINDING 3

PHEAA did not require some employees to report vehicle usage, as they should have done; PHEAA also did not require enough usage detail to provide for openness and transparency in vehicle operations.

2008 RECOMMENDATIONS

- PHEAA should revise its vehicle policy so that employees use permanently assigned cars for business purposes only.
- PHEAA should prohibit non-employees (e.g., spouses of employees) from driving state-owned cars.
- PHEAA should retain its automotive forms and supporting documentation for a minimum of four years in accordance with commonwealth records-retention policy.
- PHEAA should distribute and use an official and uniform version of the monthly automotive form to ensure that all employees are using the same form. Daily mileage, including destination information, should be recorded.

OBSERVATION 1 (CONT.)

The 2008 audit found that PHEAA made improvements to its travel policy and procedures after receiving criticism of its expenditures; however, the audit concluded that PHEAA should strengthen the policy and make it less vague and less open to interpretation. As noted, auditors raised concerns that, without specific wording and guidelines, upper-level executives could gradually migrate back to past practices. These past publicly critiqued practices include PHEAA-sponsored seminars and retreats at extravagant locations and broad use of taxpayer-funded state planes.

PHEAA responded to our request to follow up on these recommendations by providing a copy of its Corporate Travel Expense Policy and stated the policy now includes specific language defining business expenses, clear explanation of non-reimbursable expenses and approvals required for any business travel. PHEAA also stated that procedures are now in place for corporate travel cards, corporate travel, agency fleet vehicles and car rentals.

2008 FINDING 5	PHEAA made numerous improvements to its travel policy and procedures in response to criticism of its expenditures but can still do more.
2008 RECOMMENDATIONS	• PHEAA should add more specific language to its travel policy to prohibit, for example, PHEAA-sponsored seminars and PHEAA-sponsored retreats at extravagant locations both in-state and out-of-state. Furthermore, all PHEAA travel should be fiscally conservative, limited only to necessary travel, and be in-state as much as possible. • PHEAA should continue to review its internal policies and procedures as it has done with the travel policy and make further revisions where appropriate to ensure accountability to the public; along those lines, PHEAA should itself conduct a review of the 2008 travel expenses and report publicly on that review in the first quarter of 2009.

OBSERVATION 2:

PHEAA HAS IMPLEMENTED MANY RECOMMENDATIONS FROM THE PRIOR AUDIT REGARDING EXCESSIVE EMPLOYEE COMPENSATION, INCENTIVES, REWARDS, SERVICE CONTRACTS, VENDORS AND ADVERTISING, BUT MUST CONTINUE TO MONITOR EXPENSES TO ENSURE PENNSYLVANIANS CAN ACHIEVE AN AFFORDABLE EDUCATION.

The department's 2008 audit found PHEAA lapsed in important fiscal responsibilities as a state-related entity. PHEAA is responsible for the appropriate use of not only General Fund monies, but also money earned from loan services and other lending activities. The prior audit found that PHEAA lost sight of those responsibilities, treating its management staff as elite employees and spending excessively in many areas. These spending practices included excessive costs for management salaries, bonus payments, annual employee events, extensive service contracts and advertising expenses.

In its response for this follow-up report, PHEAA said it has implemented many of the recommendations from the prior audit and has worked to curtail some of its more excessive spending practices. This includes bringing most compensation packages more in line with other state agencies and curtailing most executive and management employee incentive programs. As the 2008 audit recommended, PHEAA is now offering employee events at a discounted rate instead of paying for the entirety of the event.

While many of the recommendations were implemented, a few key areas involving contractors, special vendors and IT management incentive programs must continue to be diligently monitored. We acknowledge that IT management personnel are difficult to recruit and retain, but every effort should be made to ensure that PHEAA's IT incentive program is consistent with those of programs in the most similarly situated independent state agencies (e.g., Gaming Control Board and the Public Utility Commission).

While PHEAA is unquestionably a unique state entity with commercial competitors and must compete in the private sector, it is still critical that PHEAA continue to monitor all operating expenses to ensure that taxpayer money is spent to help Pennsylvanians achieve an affordable education.

2008 FINDING 1	• PHEAA spent excessively on employee compensation and perks, service contracts, and advertising. • PHEAA created an elite compensation package for its executive staff that included excessive salaries and incentive payments not typical of a prudent state agency. • PHEAA spent excessively in many areas, including employee perks, service contracts, and advertising.
2008 RECOMMENDATIONS	• PHEAA should modify its management compensation package to be more in line with the compensation of the other state agency executives. • PHEAA should permanently eliminate its incentive programs for its executive and management employees. • PHEAA should permanently eliminate activities such as the annual Hersheypark event. However, if PHEAA wants to sponsor an "employee day" event, it should schedule such an event and request that employees pay for their attendance and that of guests, albeit at a discounted rate negotiated by PHEAA. • PHEAA should evaluate on an ongoing basis the level of professional services for which it contracts, and determine which contracts can be eliminated or renegotiated. In particular, professional services should not be a duplication of in-house professional expertise. • In cases where outside contractors must be used, PHEAA should choose such contractors in a fiscally responsible way, and by using a competitive bidding process where possible. • Also in cases where outside contractors must be used, PHEAA should not include bonuses in its contracts, nor should it include frivolous payments such as cellphones, office furniture, association dues, and other such items. • PHEAA should continue its review of all its operating expenses and continue to identify areas where costs can be brought in line with those of a typical state agency.

OBSERVATION 3:

PHEAA HAS IMPLEMENTED AN INTERNAL AND RISK-BASED AUDIT PROCESS THAT TESTS CONTROLS AND TAKES APPROPRIATE ACTIONS TO ENSURE THAT EXPENSES ARE RECORDED PROPERLY IN ACCOUNT RECORDS.

The 2008 audit found that PHEAA misclassified $2 million in expenditures when it was looking at expensive line items such as employee events, conference fees, travel expenses, advertising expenses, and consulting and contracting fees.

At the time, PHEAA acknowledged that some misclassifications occurred but noted the expenses were accounted for overall. While auditors agreed that all expenses were accounted for, this type of misclassification can negatively affect the budget process and result in an inaccurate and inconsistent presentation of financial activity.

In 2008, auditors were not able to determine the exact amount PHEAA spent in any category because of the lack of proper recording in the accounting records. This deficiency raised concerns as to whether these type of misclassifications were by accident or by design in order to avoid audit or public scrutiny.

In its response for this follow-up report, PHEAA agreed with the 2008 audit recommendations and stated it has developed a four-year risk-based audit plan that is updated annually. This auditing process reviews risks across the agency and is split into two areas: an accounting operations audit and a finance audit. These audits are reviewed by an audit review committee, which is composed of the PHEAA board. Upon completion, the audit reports are sent to the audit review committee and PHEAA senior management, as well as PHEAA's enterprise risk committee and external auditors.

2008 FINDING 2	PHEAA misclassified almost $2 million in operating expenditures when it accounted for them. Such errors raise questions about the overall accuracy of expenditure totals and also weaken PHEAA's ability to monitor expenses.
2008 RECOMMENDATION	PHEAA's internal and IT audit department should conduct periodic audits of the accounting records and tests of the internal controls and take appropriate action to ensure that all expenses are recorded properly in the accounting records. As problems are identified, PHEAA should take appropriate corrective actions. It is imperative that PHEAA record every one of its expenditures accurately in its accounting records.

OBSERVATION 4:

PHEAA HAS IMPROVED ITS PROCESS FOR VALIDATING THE ACCURACY OF TAXPAYER-FUNDED GRANT AWARDS WHEN LOOKING AT ALL APPLICATIONS, IMPROVED AUDITING PRACTICES FOR THE STATE GRANT PROGRAM, AND HAS TAKEN STEPS TO KEEP UP WITH THE RISE IN EDUCATION COSTS IN RELATION TO THE STATE GRANT AWARD PROGRAM.

In the 2008 report, auditors found PHEAA was successful in checking for the accuracy of state taxpayer-funded grant programs when looking at high-risk applications. However, they determined that PHEAA was less successful at keeping pace with rising education costs. Auditors recommended that PHEAA audit all aspects of its state grant program on a continuing basis in order to ensure the functionality and consistency of the programs.

In its follow-up response to those recommendations, PHEAA stated it has taken steps to correct the issues found in the 2008 audit. These steps include developing an income validation process to make sure the information received from FAFSA (Free Application for Federal Student Aid) for the PA State Grant program is accurate. Now, all completed and award-eligible PA State Grant applications — even those without obvious errors — go through an evaluation for income validation review on an annual basis.

PHEAA also agreed that following its risk-based internal audit plan and conducting annual audits of the state grant program were imperative to its mission. PHEAA stated that it continues to identify, document and assess risks across the agency through PHEAA's Enterprise Risk Management system to remain in good standing and to be competitive in the marketplace.

PHEAA also states it evaluates all expenses incurred by the agency to ensure they are accurate and necessary to operations. Management is responsible for managing expenses and increasing revenues in order to allow extra revenue to be supplemented to the PA State Grant Program and other program initiatives.

PHEAA explained its operating budget now coincides with the state's fiscal year, which allows PHEAA to notify the governor's office of any supplemental revenue that can be used for the following state fiscal year. According to PHEAA, this has allowed for more stable program funding and the stabilization of student awards.

Lastly, PHEAA explained that since the 2008 audit report, the Pennsylvania State Grant Advisory Committee (SGAC) was formalized by a charter that ensures the PA State Grant Program is operating efficiently and effectively.

2008 FINDING 4	PHEAA is successful in validating the accuracy of state taxpayer-funded grant awards when looking at higher-risk applications. PHEAA was less successful in keeping pace with rising education costs. Overall, regardless of its degree of success, PHEAA should audit all aspects of its state grant program on a continuing basis.
2008 RECOMMENDATIONS	• PHEAA should expand its validation process to include a random sample of records that are not error-prone to provide greater assurance that all grant funds are awarded properly. • PHEAA should follow its risk-based internal audit plan and conduct annual audits of the state grant program. • PHEAA should ensure that all its expenditures are fiscally prudent and, in doing so, determine how it can continue supplementing the taxpayer-funded state grant appropriations. • PHEAA should continue the use of its state grant advisory committee and enhance the committee's role as necessary to ensure the effectiveness of grant awards.

OBSERVATION 5:
PHEAA DISSOLVED THE PENNSYLVANIA HIGHER EDUCATION FOUNDATION IN 2015.

PHEAA had created the Pennsylvania Higher Education Foundation as a nonprofit to raise and disperse grant funds to Pennsylvania public and private schools. The foundation was mired with issues, including hiring a former CEO of PHEAA instead of a professional development director as well as not being able to raise funds to fulfill its mission.

In its response for this follow-up report, PHEAA stated it dissolved the Pennsylvania Higher Education Foundation in 2015.

2008 FINDING 6	PHEAA provided 90 percent of the funding for its affiliated Pennsylvania Higher Education Foundation, thereby enabling the Foundation to fall short of raising private contributions as it was created to do.
2008 RECOMMENDATIONS	• PHEAA should insist on superior fundraising performance from any foundation or charitable organization to which PHEAA makes significant contributions, including the Pennsylvania Higher Education Foundation, and should not allow the critical role of a development director to be filled by a president or consultant. • PHEAA's board of directors should ensure that the board members it shares with the Pennsylvania Higher Education Foundation require the Foundation to focus more on its fundraising responsibilities so that it does not continue to underperform at raising private donations.

STRENGTHENING CONSUMER CONFIDENCE IN STUDENT LOANS

A review of the troubling numbers behind America's student loan situation leaves a picture of millions of adults struggling to deal with an albatross of debt around their necks, thwarting education plans and stunting financial goals such as buying a home or moving out of Mom and Dad's house. This leads to a key question: Do the student loan industry and associated stakeholders provide sufficient information for borrowers as they navigate their financing options? Research reveals enormous room for improvement.

A 17- or 18-year-old deciding to take on tens of thousands of dollars of debt faces an intimidating decision. While some students have the assistance of knowledgeable parents, many begin this journey with little to no experience in making such consequential financial decisions. In addition, many accuse the loan servicing industry of providing inaccurate or incomplete information about loan options.

Confusion and misinformation about financing higher education center on five areas:

1. The menu of options is complex.

For many students and their families, exploring the options to pay for college introduces an entirely new set of terms whose distinctions have major implications:

- Grant vs. scholarship vs. loan
- Public vs. private loan
- Subsidized vs. unsubsidized loan
- Accrued vs. regular interest

The American Enterprise Institute, a national think tank, says, "Federal student loans are one of the most complex consumer financial products that exist in the United States."[24]

Higher education institutions are required to provide entrance and exit counseling to all students receiving federal financial aid. The American Action Forum, a national organization that uses data to provide policy insights, found that most schools are unable to personalize these counseling sections and instead comply by using the Department of Education's online loan counseling tool — and the effectiveness of that format is questionable at best.[25]

Studies suggest that student loan servicers are not filling in the information gap. According to the 2015 report by the Consumer Financial Protection Bureau: "Adequate student loan servicing can empower consumers to satisfy their financial obligations and participate fully in the economy. The servicing practices discussed in this report, when taken together, raise serious questions about whether more than 41 million American consumers with student loan debt have access to the services, information, and protections they need in order to lead healthy financial lives."[26]

[24] https://www.aei.org/research-products/testimony/testimony-servicing-federal-student-loans/
[25] https://www.americanactionforum.org/research/student-loan-counseling-federal-mandate-give-borrowers-necessary-financial-skills/
[26] https://files.consumerfinance.gov/f/201509_cfpb_student-loan-servicing-report.pdf

Failing to educate borrowers can have costly consequences. According to a study, 661,000 high school graduates missed out on $2.6 billion in free federal aid in 2018 because they failed to complete the Free Application for Federal Student Aid (FAFSA) form. Reasons cited include misconceptions they will not qualify, fears of sharing private information and making an error on the form.[27]

2. Lack of clarity in debt obligations.

Many students dedicate so much time and energy to applying for admission to college that by the time they get around to seeking financing, they may not give the task the careful attention it deserves. The loan documents themselves do little to put the incurrence of such debt into real, tangible terms:

- A study of first-year undergraduates found that half substantially underestimate their student debt amount.[28]
- A survey of recent and upcoming graduates found that respondents on average say that it will take six years to pay off their student loans; in reality, the average is closer to 20 years.[29]

3. Remarkably complex repayment options.

Unlike credit card debt, where few beneficial avenues exist if you are unable to make a payment, with student loans, a subset of 11 options exists,[30] in addition to the ability, depending on the type of loan, to seek temporary relief via deferment or a forbearance. Less than half (43 percent) of borrowers are even aware that income-based repayment plans are an option[31] and the previously mentioned ED Inspector General report cited servicers' failure to communicate such repayment plans as a viable option to eligible borrowers. Borrowers cite frustrations with navigating the student loan system as the biggest barriers to paying off their balances.[32]

4. Staying apprised of shifting policies and opportunities.

Student debt policy is consistently a hot topic in Washington, D.C., and Harrisburg, with constant discussions of reform. Communicating to borrowers about any reforms is a big task. For example, just over one-third (35 percent) of student loan borrowers in Pennsylvania are unaware that the federal CARES Act[33] — passed in response to the COVID-19 pandemic — impacts their student loans, despite the fact that their federal student loan payments were automatically suspended.[34]

[27] https://www.nerdwallet.com/blog/loans/student-loans/2018-fafsa-pell-grant/
[28] https://www.treasury.gov/resource-center/financial-education/Documents/Opportunities%20to%20Improve%20the%20Financial%20Capability%20and%20Financial%20Well-being%20of%20Postsecondary%20Students.pdf
[29] https://embed.widencdn.net/pdf/plus/cengage/qwntsqxbxh/todays-learner-student-opportunity-index-infographic-1015733-final.pdf
[30] The 11 options are income sensitivity repayment, extended 25-year plan, graduated 10-year plan, standard repayment plan for consolidation loans, graduated repayment plan for consolidated loans, standard 10-year plan, income-contingent repayment, income based repayment, revised pay as you earn, new income based repayment and pay as you earn.
[31] https://www.forbes.com/sites/prestoncooper2/2020/07/28/the-case-for-resuming-student-loan-payments/#1f70458b70f2
[32] https://static1.squarespace.com/static/597b61a959cc68be42d2ee8c/t/598a844ecd39c31515c51c7f/1502250072075/APLUS_WAVE4.pdf
[33] https://www.congress.gov/bill/116th-congress/house-bill/748
[34] https://www.apscuf.org/pennsylvanians-continue-to-struggle-with-student-debt/

5. Loan servicers providing inaccurate, misleading or incomplete information to borrowers.

Lawsuits across the country highlight stories of servicers making errors or providing misinformation to borrowers that leads to serious financial problems. Kerry Smith and Michael Froehlich of Community Legal Services, a Philadelphia-based legal advocacy nonprofit, said for this report that “time and time again we hear clients’ stories of how they reported their financial distress to student loan servicers, and instead of being placed in proper repayment plans or advised of loan discharge programs, they get enrolled in forbearance programs that only increase their debt and their chances of default.”

PENNSYLVANIA BORROWERS NEED A VOICE

The need for reform in the financing of higher education is abundantly clear. Such reform can take many shapes, whether it be simplification of the current federal loan system, a reduction in tuition or an increase in financial aid.

Absent or in tandem with such major reforms, Pennsylvania should create an independent Office of Student Loan Advocate. Such an office, sometimes called an ombudsman, has been created in several states since 2017 (Colorado, District of Columbia, Illinois, Maine, Maryland, Minnesota, New York, Nevada, Virginia, and Washington).[35] Though the specifics of their roles and duties vary across these states, the central tenet of their mission is to improve the outcomes for student loan borrowers in their states.

Improving consumer education is not a wave of a magic wand that will end the problems with financing higher education. Major reform is needed in many levels of government, with a reach far beyond loans alone. However, the creation of an Office of Student Loan Advocate will put Pennsylvanians in a stronger position within the existing framework while also advocating for reforms.

It is critical that the Office of Student Loan Advocate be independent from any conflicts of interest. Other states have housed their advocate or ombudsman in their higher education offices, state treasury, office of the attorney general and consumer/banking divisions. Though many options are worth considering, the department strongly advises that the means to dedicate funding be explored in order to create the advocate office in the Pennsylvania Office of the State Treasury. Its independence and familiarity with higher education matters via its 529 college savings program give it a strong and appropriate background to house such an office.

About HB 2360

In March 2020, state Rep. Jen O’Mara introduced HB 2360, referred to as the Student Borrower’s Bill of Rights. Among other things, the legislation calls for the creation of a “Student Loan Ombudsman” within the Department of Banking and Securities. The ombudsman would create loan materials; assist student borrowers; review complaints; create an education course for student loan literacy; and compile, analyze and report student loan data. The bill currently is in the House Education Committee awaiting consideration.

Rep. O’Mara is co-chair, along with Rep. Meghan Schroeder, of the House Student Debt Caucus. The caucus was formed to review and attempt to provide insight to reduce student loan debt held by Pennsylvanians.

[35] https://www.studentloanborrowerassistance.org/resources/referral-resource/ombudsman-programs/

PENNSYLVANIA BORROWERS NEED A VOICE (CONT.)

The department proposes five central roles for the Pennsylvania Student Loan Advocate:

1. STRATEGICALLY EDUCATE PENNSYLVANIANS ABOUT THEIR HIGHER EDUCATION FINANCING OPTIONS.

The advocate can draw from existing research and resources to create educational materials that present financial aid options in a way that can reach a wide spectrum of potential borrowers. Such information should strip away bureaucratic and financial jargon and leave critical information that is presented in a digestible way. These educational materials can be provided to high schools as well as to colleges and universities.

Seth Frotman, of the Student Borrower Protection Center, said in September 2020 that "consumers over the age of 60 are the fastest growing cohort of student loan borrowers. Many of these consumers are co-signing student loans for children and grandchildren. The Borrower Advocate can play a key role in identifying and educating the public about predatory bait-and-switch loan options which force fixed-income seniors into precarious financial obligations."

2. PROVIDE COUNSELING TO BORROWERS FEARFUL OF DEBT BALANCE.

Pennsylvania Act 121 of 2018[36] required all higher education institutions to provide an annual debt letter to all students who have taken out a loan. The debt letter provides their current debt balance, expected debt balance at graduation and estimated monthly payment balance. This public policy step is a great achievement for Pennsylvania that keeps borrowers informed. Preston Cooper of the Foundation for Research on Equal Opportunity, a national think tank focusing on economic policy, expressed concern in August 2020 that although the information is valuable, presenting it in a vacuum could lead borrowers to fear more debt accumulation and decide to drop out of school. The Student Loan Advocate may play an important role here; the debt letters sent to Pennsylvanians should include contact information for the advocate's office to help borrowers explore options before making any decisions about their future plans.

[36] https://www.legis.state.pa.us/cfdocs/legis/li/uconsCheck.cfm?yr=2018&sessInd=0&act=121

3. INFORM FINANCIALLY STRUGGLING BORROWERS ABOUT PAYMENT OPTIONS.

This may be the most critical role. Servicers have come under fire for not adequately informing borrowers of their options when the borrower is faced with economic hardship. The advocate can serve as an independent resource to personalize which options might best serve the borrower.

The advocate may also target outreach and communication to communities who are most likely to default. As Frotman said in September 2020, the advocate can help ensure that they also "have necessary information about income-driven repayment and other default mitigation tools."

4. ASSIST BORROWERS WHO ARE IN A DISPUTE WITH LOAN SERVICERS AND HELP HOLD SERVICERS ACCOUNTABLE FOR VIOLATIONS.

As cited by the state advocates of Virginia and Washington, the federal government has a questionable record on helping borrowers when issues with servicers arise.[37] The ED Inspector General stringently cited the Department of Education in a 2019 report on federal student aid for its failures to hold servicers accountable.[38] The advocate should also collect data on the categories of servicer complaints to help inform potential reforms and regulations, as well as to alert regulators such as the Office of the Attorney General and Department of Banking of any serious issues.

5. RECOMMEND PUBLIC POLICY REFORMS AND ADVOCATE FOR BORROWERS AT THE STATE AND FEDERAL LEVELS.

As Virginia Ombudsman Scott Kemp said, as more states institute a student loan advocate, the stronger the collective voice will be as states lobby the federal government for reforms to the student loan process, such as simplification of repayment options.[39] A Pennsylvania advocate also gives the commonwealth the opportunity to offer its unique voice and perspective of its citizens to national policy debates.

[37] https://sheeo.org/wp-content/uploads/2019/08/Advancing-the-Value-of-Higher-Education-through-Student-Loan-Advocacy.pdf
[38] https://www2.ed.gov/about/offices/list/oig/auditreports/fy2019/a05q0008.pdf
[39] https://www.pilotonline.com/news/education/vp-nw-student-loan-ombudsman-20200112-xti4an6ktnfz5k5v45b6sr27n4-story.html

RECOMMENDATIONS

1. **The General Assembly should create an independent Office of Student Loan Advocate to give borrowers a voice, help educate consumers, and advocate for state-related reforms in higher education.**

2. **The General Assembly should restructure PHEAA's Board of Directors, decrease the number of legislators, and add diverse members from education, finance and other fields in the private sector.**

3. **PHEAA must continue to monitor all expenses and direct as much funding as possible to help ensure that Pennsylvanians can achieve an affordable education and ensure that students take the priority over PHEAA executives and management level employees.**

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