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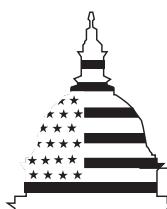
Report to the Chairman, Committee on  
Health, Education, Labor, and Pensions,  
U.S. Senate

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September 2000

# HIGHER EDUCATION

## Trustee Arrangements Serve Useful Purpose in Student Loan Market



G A O

Accountability \* Integrity \* Reliability

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## Abbreviations

FFELP	Federal Family Education Loan Program
HEA	Higher Education Act of 1965
SAP	special allowance payments

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United States General Accounting Office  
Washington, D.C. 20548

Health, Education, and  
Human Services Division

B-284774

September 25, 2000

The Honorable James M. Jeffords  
Chairman, Committee on Health, Education,  
Labor, and Pensions  
United States Senate

Dear Mr. Chairman:

In fiscal year 1999, approximately \$20 billion in loans were made to student borrowers to help meet their college expenses by lenders participating in the Federal Family Education Loan Program (FFELP).<sup>1</sup> However, because some of these lenders do not meet the definition of an eligible lender in the Higher Education Act (HEA) of 1965 and its amendments, they can only participate in the program via a trustee arrangement with an eligible lender. In 1998, HEA was amended to include a provision stating that eligible lenders that serve as trustees are responsible for meeting statutory and regulatory requirements for the loans they hold as trustees.<sup>2</sup>

Recently, your Committee raised concerns about the use of trustee arrangements and whether the trustee requirements under the 1998 amendments to HEA have led to a reduced number of eligible lenders willing to serve as trustees and to increased costs for ineligible lenders entering into these arrangements. Because of these concerns and questions regarding the usefulness of trustee arrangements, you asked us to determine (1) the number and cost of trustee arrangements and their shared characteristics, (2) the benefits and protections afforded the federal government through use of trustee arrangements, and (3) the effect of trustee arrangements on market participation and the availability of student loans. In conducting this work, we interviewed a variety of key participants in the student loan market, including federal officials, eligible lenders, ineligible lenders, guaranty agencies, and loan servicing

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<sup>1</sup>FFELP, authorized under the Higher Education Act of 1965, as amended, is one of two major federal student loan programs and was formerly known as the Guaranteed Student Loan Program. FFELP provides loans through private lenders, such as banks. These loans are insured against default by guaranty agencies, which use federal funds to pay claims and which are reimbursed by Education.

<sup>2</sup>This HEA provision codified an existing regulatory requirement promulgated in 1992.

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organizations. We also surveyed eligible and ineligible lenders participating in trustee arrangements to verify their current status and to determine the nature of their participation in the student loan program. We conducted our work between November 1999 and July 2000 in accordance with generally accepted government auditing standards. (A more detailed discussion of our scope and methodology appears in app. I.)

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## Results in Brief

The Department of Education reports that approximately 125 trustee arrangements exist between 16 eligible lender trustees and 31 ineligible lenders for the purpose of originating or purchasing student loans.<sup>3</sup> These arrangements account for \$25.3 billion in outstanding loans—approximately 19 percent of the outstanding balance of all FFELP loans as of December 1999. Costs of trustee arrangements fall into two categories—costs to initiate the arrangement and annual costs to maintain it. According to the ineligible lenders we interviewed, the costs—which ranged from \$2,500 to \$20,000 for initiation fees and from \$4,500 to \$75,000 for annual fees—did not prohibit them from conducting business in the student loan market. The amount charged by an eligible lender for its trustee services varied and was based on the volume of loans the ineligible lender was anticipated to originate and on the number and kind of other services the trustee provided. In addition, both eligible and ineligible lenders reported little, if any, change in the availability of lenders to serve as trustees or the costs of these arrangements since 1998. Several characteristics were common among the trustee arrangements we reviewed, including the criteria used by trustees to evaluate ineligible lenders before they entered into trustee arrangements, the various elements of the trustee arrangement contracts, and the day-to-day interaction between the trustee and the ineligible lender. For example, most trustees consider the business reputation of the ineligible lender and the loan servicing organization chosen by the ineligible lender in deciding whether to enter into an arrangement.

Trustee arrangements come with some protections to ensure the federal government's investment in FFELP is secure while allowing ineligible lenders to participate in the program. For example, HEA holds eligible lenders fully responsible for any loans they hold as trustees for ineligible lenders, including loans that lose the federal guarantee due to problems

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<sup>3</sup>Trustees and ineligible lenders may be party to one or more arrangements; thus the number of trustees and the number of ineligible lenders do not add to 125.

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such as lender negligence. Because these problems may not be discovered until after the government has paid the guaranteed amount, this HEA provision allows the federal government to recoup any losses from the eligible lender trustee rather than the ineligible lender. Education officials believe the government is likely to recover its losses from trustees for two reasons. First, most financial institutions that serve as eligible lender trustees are subject to federal (and in many instances, state) oversight. For example, bank regulators promulgate regulations and policies that prescribe safe and sound banking activities and examine banks to assess their safety and soundness. Second, because most eligible lender trustees also hold student loans in their own name and receive regular FFELP-related payments from the government for those loans, the federal government has recourse for recovering any repayments due the government on ineligible lenders' loans that lose the federal guarantee. Education officials stated that because ineligible lenders are generally not subject to financial safety and soundness reviews by government agencies, Education lacks assurance that these lenders would be able to meet their financial obligations in the program.

Both eligible and ineligible lenders said they believe that market participation and loan availability are positively affected by trustee arrangements because such arrangements allow lenders that do not meet HEA's eligible lender definition to make and hold loans. These lenders said that the presence of additional lenders in the market increases competition and thus helps to enhance the products and services lenders offer to students. However, ineligible lenders said that two factors—HEA requirements and the general evolution of financial markets—could affect their continued participation in the future. For example, HEA currently limits the proportion of student loans certain eligible lenders can hold in relation to other holdings, and strict application of this provision would require eligible lenders to include loans held as a trustee in their calculations. Education officials acknowledged that Education currently interprets the provision as not including trustee-held loans but has inconsistently applied this provision in the past, resulting in confusion among eligible and ineligible lenders as to which lenders can serve as a trustee. In addition, ineligible lenders reported that the number of available trustees has decreased as banks have merged with each other in recent years. We are recommending that Education formally clarify the agency's interpretation of the HEA trustee-related provision. In commenting on this report, Education agreed with this recommendation.

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## Background

Education administers and oversees federal student aid programs authorized by HEA, monitors participants' activities, and establishes program requirements. Among these financial aid programs is FFELP. The five principal entities involved in FFELP are students, schools, lenders, guaranty agencies,<sup>4</sup> and Education. At schools participating in FFELP, students apply to a participating lender for a loan. The school verifies the student's eligibility and determines the loan amount the student is eligible to receive. The student then receives the loan from the lender. The guaranty agency guarantees the loan against default. The guaranty agency is the intermediary between Education and the lender, insuring the loan against default and making certain that the lender and the school meet program requirements. The lender is responsible for servicing and collecting the loan, and, if the student defaults on the loan, the lender files a claim with the guaranty agency for reimbursement of most of its loss.<sup>5</sup> Education reimburses guaranty agencies for most of their claims paid to lenders for defaulted loans and for some of their administrative costs. Most lenders contract with a third-party entity to service the loan and collect payments from borrowers.

HEA designates which entities are eligible to make FFELP loans to students. In general, an eligible lender is defined as

- under certain circumstances, a national or state chartered bank, a mutual savings bank, a savings and loan association, a stock savings bank, or a credit union;
- a pension fund as defined in the Employee Retirement Income Security Act;
- an insurance company that is subject to examination and supervision by an agency of the United States or a state;
- in any state, a single agency of the state or a single nonprofit private agency designated by the state;

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<sup>4</sup>A guaranty agency is a state or private nonprofit organization that administers a loan guarantee program under HEA.

<sup>5</sup>Guaranty agencies use their federal fund to reimburse lender claims. When a claim for a defaulted loan is made by a lender to the guaranty agency, regulations require the agency to pay the lender 98 percent of the loss amount. Education then reimburses the guaranty agency for up to 95 percent of the loss amount. In certain cases, such as the death or disability of the student, the reimbursement is 100 percent for both the lender and the guaranty agency.



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- under certain circumstances, an eligible institution<sup>6</sup>;
  - under certain circumstances, the Student Loan Marketing Association or the Holding Company of the Student Loan Marketing Association, including any subsidiary of the Holding Company, or an agency of any state functioning as a secondary market;
  - under certain circumstances, a guaranty agency;
  - a Rural Rehabilitation Corporation;
  - under certain circumstances, any nonprofit private agency functioning in any state as a secondary market; and
  - a consumer finance company subsidiary of a national bank.

The majority of organizations making loans to students fall into one of these eligible lender categories. However, organizations that do not meet HEA criteria may still participate in FFELP by contracting with an eligible lender to serve as its trustee.<sup>7</sup> These ineligible lenders fall into two categories: (1) secondary markets<sup>8</sup> that have not been designated as an eligible lender for a state and (2) private companies that wish to make and hold student loans.<sup>9</sup>

Ineligible lenders generally contract with trustees for three purposes. First, ineligible lenders contract with trustees to allow the ineligible to originate student loans or to purchase them from another originating lender. Second, ineligible lenders use trustees to securitize portfolios of student loans.<sup>10</sup> Third, trustees are used when ineligible lenders need to raise the capital necessary to make or purchase student loans without securitizing other loans. For example, some secondary markets raise capital by selling tax-exempt

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<sup>6</sup>An eligible institution is generally an institution of higher education.

<sup>7</sup>A trustee is a person or entity, such as a bank, holding legal title to property in order to administer it for a beneficiary. In the case of student loans, eligible lender trustees hold title to the loans that ineligible lenders originate or purchase, thus allowing them to participate in FFELP. As of July 2000, all but one trustee was a bank.

<sup>8</sup>Secondary markets are lending institutions that purchase guaranteed student loans from originating lenders to provide the lenders with funds to make new loans. Twenty of the approximately 37 secondary markets are designated as eligible lenders and do not need a trustee to originate or purchase student loans.

<sup>9</sup>These entities are referred to in this report as “other ineligible lenders.”

<sup>10</sup>Portfolios of student loans—originated or purchased by eligible or ineligible lenders—can be used as collateral to issue securities to investors. The proceeds of these transactions are then used by the lender to originate new loans to students. This process is known as securitization.

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bonds to investors. This report is concerned primarily with trustee arrangements used to enable ineligible lenders to make and hold student loans.

At FFELP's outset the government expected to share the program's financial risks with state-designated guaranty agencies. However, when states failed to establish such agencies, the Congress enacted legislation with several incentives to increase lender and guaranty agency participation. For example, the Congress provided federal funds for guaranty agencies to use as seed money to pay claims to lenders. In providing these incentives, the Congress kept the financial risk almost entirely with the federal government. The Congress has since shifted some risk back to the guaranty agencies and lenders by reducing the maximum reimbursement and insurance rates on defaulted loans. These actions were intended to encourage both lenders and guaranty agencies to work with borrowers to prevent them from defaulting on their loans. Apart from the defaults that occur when borrowers fail to repay their loans, some loans lose their federal guarantee because lenders, servicers, or guaranty agencies fail to follow the Department's requirements for making, servicing, and collecting loans or because of fraudulent activity at these organizations. When these latter circumstances occur, Education may assess penalties, refuse to make future payments, or recover payments already made to lenders and agencies for such things as interest subsidies and insurance claims. In 1998, HEA was amended to include a provision stating that eligible lenders that act as trustees are responsible for meeting statutory and regulatory requirements for the loans they hold as trustees.

Loss of the federal guarantee due to servicer problems has occurred under the auspices of trustee arrangements in the past. For example, in the late 1980s, Bank of America served as trustee for the California Student Loan Finance Corporation—a California secondary market. Education determined that the loan servicer, United Education and Software Company, failed to transfer certain information to its new computer system and then created a computer program that falsely added collection activity information for a large volume of loans held by the secondary market. As a result, student loans totaling approximately \$400 million lost their federal guarantee. However, servicer problems that may result in loan guarantee loss can also occur on loans held by eligible lenders and are not unique to trustee arrangements.

## Trustee Arrangements Represent Nearly One-Fifth of Outstanding Loans and Share Several Characteristics

The Department of Education reports that approximately 125 trustee arrangements exist between eligible and ineligible lenders. These arrangements account for \$25.3 billion in outstanding loans—approximately 19 percent of the outstanding balance of all FFELP loans as of December 1999.<sup>11</sup> The 125 arrangements represent liaisons between 16 eligible lender trustees and 31 ineligible lenders. Ineligible lenders can be further grouped as 17 secondary markets and 14 other ineligible. Table 1 shows the outstanding balance of loans held via trustee arrangements for the two categories of ineligible lenders.

**Table 1: Outstanding Balance of Student Loans Held via Trustee Arrangements**

Category of ineligible lender <sup>a</sup>	Outstanding loan balance <sup>b</sup>
Secondary markets (17)	\$11.2 billion
Other ineligible lenders (14)	\$14.1 billion

<sup>a</sup>Numbers in parentheses indicate number of lenders in category.

<sup>b</sup>As of December 1999 (the most complete information available from Education as of July 2000).

Source: Department of Education FFELP Lender Database.

Costs of trustee arrangements fall into two categories—payments to initiate the agreement and annual fees to maintain it. The ineligible lenders we interviewed reported that initiation costs were generally a flat fee ranging between \$2,500 and \$20,000. Some of these ineligible lenders, such as some secondary markets, reported that their trustee (who serves as trustee for raising capital as well as for originating and purchasing loans) charged this initiation fee each time they issued bonds to raise capital. Annual trustee fees reported by ineligible lenders ranged between \$4,500 and \$75,000, depending on a number of factors. These lenders reported that the fees could be a flat fee or calculated as a percentage of outstanding loan balances or on the outstanding balance of bond issues. Ineligible lenders reported that annual costs are used to maintain the arrangement and cover the necessary services provided by the trustee, such as transferring documents between the trustee and the ineligible lender for signature,

<sup>11</sup>We included outstanding loan balances for originations and purchases, as well as securitizations of the loans originated or purchased by ineligible lenders. We also included outstanding loans made under the Student Loan Marketing Corporation's privatized operations because a trustee is needed to originate and purchase loans in this circumstance.

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handling paperwork associated with the guarantors and servicers involved in the loan transactions, and carrying out administrative activities associated with obtaining financing to originate or purchase loans. Some eligible and ineligible lenders reported that a variety of other factors could influence the size of both initiation and annual fees. Some of these factors included

- the structure of the trustee arrangement and the complexity of the proposed transactions,
- the geographic region in which the trustee and ineligible lender are located,<sup>12</sup>
- the trustee's decision to charge administrative fees on a per-loan basis rather than as a flat fee,
- the additional services the trustee will perform for the ineligible lender, such as payroll services, and
- the strength of the trustee's relationship with the ineligible lender.

Although some ineligible lenders feared that the provision of HEA that makes trustees fully responsible for trustee-held loans might have an impact on costs, they reported that costs did not significantly increase or decrease after the 1998 amendments were enacted and that they did not see a change in the role of the trustee.<sup>13</sup> According to ineligible lenders we interviewed, current initiation and annual trustee fees do not prohibit them from conducting business in the student loan market.

The trustee arrangements we reviewed shared several characteristics. Trustees and ineligible lenders reported similar (1) criteria used by trustees to evaluate ineligibles before they entered into arrangements, (2) elements in trustee arrangement contracts, (3) amounts of review performed of ineligible lenders, and (4) amounts of day-to-day interaction between the trustee and the ineligible lender. For example, trustees reported that most important in deciding whether to enter an arrangement is the business

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<sup>12</sup>One eligible lender representative reported that the trustee might charge a lower fee if the ineligible lender were located in an area where the eligible lender wished to build a market presence.

<sup>13</sup>In commenting on this report, Education stated that the 1998 statutory change may not have had a significant effect because the change merely codified existing regulations.

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reputation of the ineligible lender<sup>14</sup> and the reputation of the loan servicing organization it has chosen. In addition, some trustees review the structure of the financing method used by the ineligible lender to raise the capital necessary to originate or purchase loans. This review might include examining a rating agency's report on the transaction.<sup>15</sup>

Trustees and ineligible lenders also reported that their contracts included similar clauses covering trustee and ineligible lender resignations and requirements placed on the ineligible lender. For example, they reported that trustee resignation clauses allow the trustee to resign from the arrangement by giving a specific number of days' notice to the ineligible lender, such as 60 or 90 days. If the ineligible lender is unable to locate another trustee within that time period, the resignation clause sometimes provides for additional time to obtain a new trustee. In any event, most trustees and ineligible lenders reported that the trustee would probably remain in place until a new one can be engaged, even if the designated time periods have elapsed. The trustee arrangements we reviewed were also similar in the requirements placed on the ineligible lender and the amount of monitoring the trustee performed. For example, trustees generally require ineligible lenders to abide by HEA requirements and to oversee the loan servicer, but the trustees perform limited monitoring activities. One trustee reported that the monitoring is not specific or regular and mostly involves a review of annual reports and audits. Other trustees reported limiting their monitoring to a review of financial statements. Eligible lender trustees and ineligible lenders reported limited day-to-day interaction. For example, some trustees reported that they interact with the ineligible lender only when it is necessary to sign forms, such as quarterly reports that must be submitted to the Department of Education. One trustee reported no daily interaction.

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<sup>14</sup>Some ineligible lenders served in other roles prior to becoming a lender, such as a guaranty agency or a servicer.

<sup>15</sup>Rating agencies assess credit risks on bonds and other financial instruments. Such ratings help investors, such as those who purchase bonds, to manage their credit risk by providing risk analysis and evaluation information.

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## Trustee Arrangements Come With Some Protections for Federal Investment in Student Loan Program

Trustee arrangements come with some protections to ensure the federal government's investment in FFELP is secure while allowing ineligible lenders to participate in the program. The most direct protection comes from an HEA provision that holds eligible lenders fully responsible for any loans they hold as trustees should the loans lose the federal guarantee. For example, although Education officials and other FFELP participants believe the probability of large-scale problems is low, a loan may lose its guarantee because of servicing errors or because of negligence on the part of the servicer or the lender. When these problems occur, the federal government will not reimburse the guarantor or the lender for the associated dollar loss. However, because some problems may not be found until after the federal government has already provided reimbursement, the government may have to recover these monies from the parties involved.

According to Education officials, the HEA provision that holds trustees responsible for an ineligible lender's loans allows the federal government to recoup the losses from the eligible lender trustee rather than the ineligible lender. Education officials further stated the ability to recoup losses from a trustee is important since they believe they do not have direct oversight authority of ineligible lenders. These officials believe the federal government is likely to recover its losses from trustees for two reasons. First, most financial institutions that serve as eligible lender trustees are subject to federal (and in many instances, state) oversight. For example, bank regulators<sup>16</sup> promulgate regulations and policies that prescribe safe and sound banking activities and examine banks to assess their safety and soundness. Among the most important of these regulations are those dealing with minimum capital standards. These capital standards provide benchmarks against which regulators can assess the safety and soundness of a bank's operations as well as its financial condition. Education officials stated that because ineligible lenders are generally not subject to financial safety and soundness reviews by government agencies, Education lacks assurance that these lenders would be able to meet their financial obligations in the program. Second, because most eligible lender trustees also hold student loans in their own name and receive regular FFELP-related payments from the government for those loans, the federal government has additional sources from which to recover any repayments

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<sup>16</sup>Financial regulators for banks include the Office of the Comptroller of the Currency, the Federal Reserve System, the Federal Deposit Insurance Corporation, and state banking regulators.

due the government on ineligible lenders' loans that lose their guarantee. For example, lenders usually receive special allowance payments (SAP) and interest subsidies<sup>17</sup> for the FFELP loans they hold. If the government were owed monies on an ineligible lender's loans, it could recover those funds by withholding the SAP on the eligible lender trustee's self-originated loans. Because ineligible lenders do not receive any payments directly from Education, it does not have an ability to collect liabilities by offset.

## Participants Believe Trustee Arrangements Positively Affect Student Loan Market, Although Some Have Concerns Over Future Trustee Availability

Both eligible and ineligible lenders reported that trustee arrangements have had a positive effect on the student loan market. For example, both participant groups believe that market participation and loan availability are positively affected since trustee arrangements allow lenders that do not meet HEA's eligible lender definition to make and hold loans, thus increasing the amount of loan capital available to students. These trustee arrangements allow ineligible lenders not only to originate loans, but also to purchase loans that other lenders have originated. This purchasing role—the primary role for many ineligible secondary markets—permits originating lenders to free up capital to make new loans to students. Eligible and ineligible lenders agree that participation by ineligible lenders increases competition among lenders and can, in turn, contribute to improved service and lower costs for student borrowers.

Some ineligible lenders, however, believe that two factors—HEA requirements and the general evolution of financial markets—could affect their participation in the student loan market in the future. HEA currently states that a bank functioning as an eligible lender cannot have as its primary consumer credit function the making or holding of student loans. Education, in its FFELP regulations, interprets the act to mean that the lender's FFELP loans—or in the case of a bank holding company, the FFELP loans of the company's wholly owned subsidiaries as a group—cannot total more than one-half of the lender's combined consumer credit loan portfolio, including home mortgages held by the lender or its subsidiaries. This provision is commonly known as the 50-percent rule.

<sup>17</sup>Education pays a special allowance to lenders on eligible FFELP loans to bridge the gap between borrower interest rates set by statute and the interest rate a lender could charge if the loan funds were used for commercial purposes. The special allowance is a percentage of the average unpaid principal balance of the loan, including capitalized interest, computed in accordance with federal regulations. Interest subsidies are interest payments made to lenders on subsidized loans while the borrower is in school or in deferment.

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Strict application of this rule would require eligible lenders to include loans they hold as a trustee for an ineligible lender in this calculation, although the regulations do not specifically address these loans. Education officials told us that although Education has inconsistently applied the regulations in the past, it currently interprets the provision as excluding trustee-held loans in determining the lender's primary consumer credit function, but has not formally promulgated its interpretation. Lenders have expressed confusion regarding application of the rule. For example, some ineligible lenders and other student loan market participants believe that the 50-percent rule applies to loans held as a trustee and thus believe that only a handful of large banks have sufficient consumer credit capacity to serve as a trustee. Similarly, while a few eligible lender trustee representatives interpreted the rule as not applying to trustee-held loans, some other representatives were not sure how the rule should be interpreted. Of those who were unsure, one trustee representative was not concerned because either calculation—including or excluding the loans—would place the bank in compliance with the act. Representatives of one bank incorrectly interpreted an exception to the 50-percent rule.<sup>18</sup> On the other hand, a representative of another bank stated he had turned down eligible lender trustee business because the additional trustee-held loans would put the bank above its 50-percent allocation of student loans.

A second factor that is perceived by ineligible lenders as having the potential to limit their participation in FFELP is evolution in the financial markets. Most ineligible lenders we interviewed stated that the number of available trustees has decreased as eligible lender banks have merged with each other in recent years. Recent mergers include First National Bank of Chicago and Bank One, Norwest and Wells Fargo, and Firststar Bank with Star Bank and Mercantile Bank (St. Louis); financial market analysts expect this consolidation activity to continue. Four ineligible lenders reported they had a difficult time obtaining their current trustee arrangement, one taking over a year to do so. Several others said that finding a trustee in the future would become more problematic. Ineligible lender representatives also expressed concern that because trustees also originate student loans for themselves, trustees may decide to end their

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<sup>18</sup>One exception to the 50-percent rule is “a bank which is subject to examination and supervision by an agency of the United States, makes student loans as a trustee pursuant to an express trust, operated as a lender under [the Stafford loan program] prior to January 1, 1975, and which meets the requirements of this provision prior to [July 23, 1992].” 20 U.S.C. section 1071(d)(1)(A)(ii). An Education official indicated that these criteria apply to only one specific bank, which is not the bank we interviewed.



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eligible lender trustee services rather than continue to provide the mechanism for a competitor to do business. A few ineligible lenders stated they were uncomfortable with trustees having the final say as to which ineligible lenders can participate in the student loan market. Given these issues, some ineligible lenders believe their market presence could diminish in the future.

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## Conclusions

Given current law and the federal regulations that govern FFELP, trustee arrangements between eligible and ineligible lenders serve an important role in enabling ineligible lenders to participate in FFELP, and in protecting the federal government's investment in the program. The presence of an eligible lender from whom the government can recoup its financial losses is critical since Education has no direct oversight authority to ensure that ineligible lenders are operating their programs in accordance with HEA. Obtaining a trustee arrangement does not appear to be a widespread problem among ineligible lenders to date. However, if eligible lenders remain unclear and therefore continue to interpret the 50-percent rule as applying to loans they hold as a trustee, and if the financial industry continues to consolidate, the number of trustees could decline. This decline could, in turn, reduce competition in the student loan market.

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## Recommendation for Executive Action

To clarify eligible lenders' capacity to serve as trustees for ineligible lenders, the Secretary of Education should formally clarify Education's interpretation of how the HEA provision prohibiting banks or their subsidiaries from holding FFELP loans that total more than one-half of their combined consumer credit loan portfolio applies to loans held by the trustee for an ineligible lender.

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## Agency Comments

Education agreed with our recommendation that it clarify its interpretation of how the HEA provision applies to loans held by the trustee for an ineligible lender. Education said that it has not yet decided which policy to establish nor how to formalize the decision once it is made. Education did not say when it expected to implement our recommendation. Education also provided technical comments, which we incorporated where appropriate. (See app. II for a copy of Education's comments.)

We are sending copies of this report to the Honorable Richard Riley, Secretary of Education; eligible lender trustees; ineligible lenders; and other interested parties. Copies will also be made available to others on request.

If you or your staff have any questions about this report, please call me at (202) 512-7215. Other major contributors to this report are listed in appendix III.

Sincerely yours,

A handwritten signature in black ink that reads "Barbara D. Bovbjerg". The signature is written in a cursive style with a large, stylized initial "B".

Barbara D. Bovbjerg  
Associate Director, Education, Workforce,  
and Income Security Issues

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# Scope and Methodology

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We focused our review on trustee arrangements created to allow ineligible lenders to originate or purchase student loans. To determine the number of existing trustee arrangements, we obtained data from Education's lender database, including the names of the parties involved in each trustee arrangement, the lender identification number<sup>1</sup> associated with each arrangement, and the outstanding loan balances. These data represent the best information available, and an Education official acknowledged that the list might be incomplete. To verify the parties involved in the identified arrangements and to determine the type of student loan transactions that made up the outstanding balance associated with a particular lender identification number, we surveyed eligible and ineligible lenders. For each lender identification number on the trustee arrangement list, we asked the lenders to verify whether the account was used for originations and/or purchases of student loans, securitizations, or some combination of these transactions. We also asked lenders to provide us with information on any additional identification numbers used for trustee arrangements. We conducted follow-up interviews as necessary to ensure that we received accurate information. In determining the total outstanding balance of loans associated with trustee arrangements, we included information only for arrangements that allow ineligible lenders to originate or purchase student loans and securitizations of these loans. Further, we included balance information only for the Student Loan Marketing Corporation's privatized business and the ineligible lenders it owns, such as Nellie Mae Corporation, because these organizations must use a trustee to originate or purchase loans. To obtain detailed information on the identified trustee arrangements, the costs associated with them, and the key characteristics they shared, we interviewed Education officials, eligible lender trustee representatives, and representatives of ineligible secondary markets and other ineligible lenders. In addition, we conducted joint interviews with three sets of trustees and ineligible lenders involved in trustee arrangements and obtained a written response from another. Further, we obtained information through interviews about the impact of the 1998 amendments to HEA on the number of eligible lenders willing to serve as trustees and on the costs of trustee arrangements.

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<sup>1</sup>Education tracks student loan activity primarily via information reported for a specific lender identification number. Education issues lender identification numbers to each eligible lender wishing to participate in the student loan program. When a trustee arrangement is created, Education issues a new number to reflect the loan activity of the ineligible lender via its trustee.

To determine the protections offered the federal government by trustee arrangements, we identified and synthesized applicable legislation and regulations and reviewed sample documents for trustee arrangements. We also interviewed eligible and ineligible lenders, guaranty agencies, servicers, Education officials, and other student loan market participants on the responsibilities of an eligible lender trustee and the process Education uses to oversee market participants and to recoup any losses it may incur on defaulted loans.

To determine the effects of trustee arrangements on participation in the student loan market and the availability of student loans, we interviewed eligible and ineligible lenders, secondary markets, guaranty agencies, servicers, Education officials, and other student loan market participants. We obtained the perspectives of participants on whether trustee arrangements have a positive or negative effect on lenders' participation in the student loan market and identified past, current, and potential problems lenders faced in using trustee arrangements. Because of the competitive nature of the student loan market, information obtained from the lender community was sometimes general in nature. We also obtained Education officials' interpretation of applicable laws and their views on the effects of past rulings regarding trustee arrangements.

# Comments From the Department of Education



UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF POSTSECONDARY EDUCATION

SEP - 4 2000

THE ASSISTANT SECRETARY

Ms. Barbara D. Bovbjerg  
Associate Director  
Education, Workforce and Income Security Issues  
United States General Accounting Office  
Washington, DC 20548

Dear Ms. Bovbjerg:

The Secretary has asked me to respond to your request for comments on the General Accounting Office (GAO) draft report, "Higher Education: Trustee Arrangements Serve Useful Purpose in Student Loan Market" (GAO/HEHS-00-170), which was transmitted to the Department of Education by your letter of August 4, 2000.

Thank you for the opportunity to review this draft report. We appreciate your examining a complicated subject area and providing very useful information. My staff had previously shared our technical comments with your office that, we think, would aid the reader's understanding of the student loan program in general, and this statutory provision in particular.

The Department agrees with your recommendation that we formally clarify our interpretation of the trustee-related provisions in the Higher Education Act of 1965, as amended (HEA), especially with respect to the "50 percent rule" in the definition of an eligible lender.

However, at this time the Department has not established its policy preference, nor have we decided the mechanism we would employ to express our policy interpretation. As you know, we are required by statute to engage in a process of negotiated rulemaking when we propose to amend the regulations implementing the programs authorized under Title IV of the HEA. Alternatively, we may be able to clarify our interpretation by subregulatory means, such as a Dear Colleague Letter.

If you or your staff have any questions, please do not hesitate to contact my office.

Sincerely,

A handwritten signature in black ink, appearing to read "A. Lee Fritschler", followed by a horizontal line extending to the right.

A. Lee Fritschler

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