



Ensuring Accountability and Effectiveness at the Office of Federal Student Aid

By Ben Miller and Jason Delisle May 2019

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Introduction and summary

The fifth-largest bank in the United States does not occupy a fancy office tower in Manhattan, nor does it employ hundreds of thousands of individuals in offices around the country.¹ Instead, most of its 1,300 employees sit in an 11-story building on a small street tucked away behind Washington, D.C.'s Union Station.² From that base of operations it manages a massive portfolio that affects 1 out of every 6 adult Americans.

In fact, the bank is not even a financial company but rather the Office of Federal Student Aid (FSA), a unit within the U.S. Department of Education. This office disburses roughly \$120 billion each year in grants and loans to help millions of students access and afford an education beyond high school. It also oversees a total loan portfolio of \$1.4 trillion.³ It does this on a total budget of about \$1.7 billion a year, about half of which is spent on outside contractors to service student loans.⁴

FSA's role in managing the federal student aid programs also differs from that of a typical bank. Congress, not FSA, sets the terms and conditions for the programs the office administers and dictates the agency's budget through the annual appropriations process. The U.S. Department of the Treasury provides the capital for loans. And the Department of Education handles issues related to cost projections; provides the office's legal counsel; and is responsible for policy decisions that affect the portfolio.

As student loans become an increasingly common tool that Americans use to finance higher education, there are significant worries about the management and oversight of the federal financial aid programs. Watchdogs within the government have raised concerns about a range of issues in the aid programs, including:

- Whether students are sufficiently protected from low-quality institutions of higher education
- Whether there is enough accountability around the private companies that service federal student loans on the Department's behalf⁵
- Whether the amount of transparency around loan repayment outcomes is sufficient⁶
- How the cost of loan repayment plans is estimated⁷

Although the responsibility for some of these issues, such as cost estimation, rests more with the Education Department than with FSA, some observers in the policy community are increasingly using these concerns to question whether these problems might be related to FSA's unique organizational structure.⁸ FSA is 1 of only 3 federal offices designated as a performance-based organization (PBO)—a structure intended to make FSA function more like a private enterprise with a focus on strategic goals and outcomes. Offices that hold this status receive exemptions from typical federal rules around hiring and procurement as well as compensation practices, including the option of paying bonuses to senior managers.⁹ Similarly, the PBO structure establishes the head of FSA as a chief operating officer (COO) on contract rather than a political appointee. In exchange for these flexibilities, the agency must carry out purposes and functions that Congress spells out in statute and follow a set of strategic goals through an internal performance plan developed with the Education Department.

While FSA's PBO designation establishes these flexibilities and independence, some in the policy community have criticized the PBO structure in recent years. Critics have argued that FSA has not faithfully adhered to the PBO concept or that the PBO framework frustrates transparency, accountability, and policy reforms.

This report finds a more complicated story. The criticisms leveled against PBOs in recent years have a degree of merit. Yet some of these complaints concern issues that lie with the Education Department, and others may be a function of how PBOs are conceptually supposed to operate. The PBO structure was designed to be somewhat independent from political pressures, which its drafters saw as a feature that would allow it to focus on day-to-day business operations and avoid the distractions of the latest policy agenda. But that independence can cut both ways, making the agency seem unresponsive to the directives of officials at the Education Department or even Congress.

Resolving the tensions between independence and political accountability requires that policymakers hold the PBO and its COO to the goals that Congress has set in law—not overhaul or abandon the PBO structure entirely. In theory, those goals are enforced through the contracts and strategic plans that FSA leadership develops with the Education Department. In recent years, policymakers have treated these goals—which are intended to provide accountability and offset the independence and flexibilities they granted the PBO—as an afterthought. Congress has not meaningfully updated the goals of the PBO since the legislation's 1998 inception; in fact, recent Democratic and Republican proposals to overhaul and reauthorize the Higher Education Act (HEA) include minimal substantive changes to FSA's structure and goals as a PBO.¹⁰

Today's criticisms of the PBO also fail to acknowledge the prior problems that the structure was meant to address. Major operational issues such as extensive delays in processing financial aid applications or rampant undetected fraud and abuse in grant and loan programs plagued FSA in the 1990s.¹¹ The political appointees in charge of FSA during this time also had little experience running a major financial enterprise and were therefore less well equipped to handle operational challenges.¹² The extent to which the PBO structure helped remedy these problems must be considered in any debate about its benefits and shortcomings. Otherwise, policymakers risk reintroducing the conditions that gave rise to the problems in the first place.

Overall, the authors find that the PBO is neither panacea nor pariah; the structure provides useful operational tools and abilities, but it requires a different type of management and oversight than a traditional government agency. This means that both Congress and the Education Department need to be more structured and diligent in setting goals for FSA and holding it accountable for its performance. To that end, this report starts with a brief history of PBOs in the United States and how FSA gained this status. It then discusses the PBO's intended structure and purposes as well as its benefits and potential problems. The authors conclude with guidance for policymakers who wish to improve FSA's operations and accountability—while maintaining its status as a PBO—as Congress pursues work on reauthorizing the HEA. This guidance includes the following:

- **Congress should consider necessary updates to the statutory goals and structure of the PBO:** In doing so, it should ignore calls for more radical solutions such as jettisoning the structure or moving all FSA operations to another Cabinet agency. To be sure, federal aid programs have become larger and more complicated since FSA became a PBO, creating oversight challenges not contemplated in the 1990s. For this reason, policymakers should consider updates to the PBO that address today's problems rather than ending it entirely. Updates should include a greater emphasis on transparency and oversight.
- **The Education Department should make improvements to its management of FSA.** Current and future administrations should develop more detailed and clearer five-year performance agreements for the agency and its COO that are backed by meaningful oversight and accountability for results. These agreements should include specific objectives to achieve the plan's goals, avoiding vague language leading to immeasurable outcomes. Agency leaders should also ensure that senior appointees and FSA officials develop productive, close working relationships.

These suggestions derive from more than two dozen interviews and conversations the authors conducted with individuals who worked at or with FSA from the Clinton administration through the present day. This includes high-level appointees and career staff in the executive branch, senior managers who worked at FSA, and congressional staff. The authors conducted these interviews off the record to encourage candor. Thus, this report does not share direct quotations from these interviews. The authors also conducted extensive reviews of legislative history, hearings, government reports, and other documents related to FSA.

It has been more than 20 years since FSA changed its status to operate more like a private business. As the federal investment in college aid becomes increasingly important, policymakers should look to maximize the advantages of that unique structure—not abandon it in search of a new management design that may not improve performance.

A history of PBOs and Federal Student Aid

The idea of a performance-based organization (PBO) has its roots in former Prime Minister Margaret Thatcher’s government in England. Starting in the late 1980s, many government offices there became “Next Steps agencies.”¹³ The idea was to improve efficiency by combining some government functions with private sector practices: Agency heads took on roles that more closely resembled chief executive officers, and—in exchange for freedom from traditional government rules around personnel—the agency and its heads would be judged based on a clearer set of measurable outcomes.

The idea crossed the Atlantic in the 1990s after the Clinton administration launched its National Partnership for Reinventing Government initiative.¹⁴ Then-Vice President Al Gore led this work and laid out ideas to make government more responsive, focused on customers, and efficient.¹⁵ The reinventing government work imported the basic concept of Next Steps agencies but rebranded them as PBOs. The initiative’s early recommendations targeted smaller offices or agencies with missions less complicated than the FSA’s such as the Saint Lawrence Seaway Development Corporation,¹⁶ a government corporation that manages the connection between the Port of Montreal and Lake Erie.¹⁷

The decision to designate FSA as a PBO

The reinventing government agenda did not initially envision FSA as a PBO. At the time, FSA was run by a political appointee who reported to the assistant secretary for postsecondary education—meaning the head of FSA was several levels removed from direct contact with department leadership and typically lacked a background in business operations or management.¹⁸

But as the Clinton administration was thinking through ways to restructure certain government agencies, FSA faced significant operational problems. The 1990s started with sky-high default rates on federal student loans and worries that the Education Department was losing billions of dollars each year to waste fraud and abuse.¹⁹ In

1992, the then-U.S. Government Accounting Office placed federal student loans on its list of high-risk programs and then added the rest of the financial aid programs to the list in 1995.²⁰ In the mid-1990s, the department had trouble processing nearly 1 million financial aid applications due to computer problems.²¹ A few years later, it had to suspend a student loan refinancing program because it could not keep up with demand.²²

In 1998, as the reauthorization of the HEA approached, Congress brought together the two threads of government reform and FSA's problems. Reps. Buck McKeon (R-CA), William Clay (D-MO), William Goodling (R-PA), and Dale Kildee (D-MI) introduced a bill proposing to convert FSA into a PBO.²³ During this process, Rep. McKeon stressed operational challenges with FSA:

Unfortunately, today, under the current system, taxpayers are paying more and students are getting less. The Department of Education's budget for information systems has tripled over the last 5 years. Next year alone it will spend over \$300 million on systems contracts to deliver student aid. Yet despite these significant expenditures, the current system is still wrapped in miles of redtape, requires dozens of paper forms, and suffers from needless processing delays and breakdowns.

Mr. Speaker, I believe that there is a better way for the Department of Education to do business. In fact, under the legislation that I am proposing today, the Department's student financial aid systems would be run more like a business—adopting the best practices from the private sector and focusing on bottom line results.²⁴

That legislation was eventually wrapped into the larger reauthorization of the HEA, which passed with near unanimous support in 1998.²⁵ Although it had not been on the initial list of possible PBOs, reinventing government personnel welcomed the change. The Education Department even tapped Greg Woods, a vice president of the reinventing government task force, to serve as FSA's first COO.²⁶

Comparing FSA with other PBOs

Although the Clinton administration proposed creating as many as nine PBOs, Congress ultimately only established three: FSA, the Patent and Trademark Office within the U.S. Department of Commerce, and the Air Traffic Organization within the Federal Aviation Administration.²⁷ The latter two PBOs were created in 2000.²⁸ This limits the number of comparisons that can be made when judging the effectiveness of FSA relative to the performance of other PBOs.

FSA differs from the other two PBOs in several key ways—one of which is revenue-generation. Since 2011, the Patent and Trademark Office has been able to keep the user fees it charges, which now generate enough revenue for the office to be self-sustaining and not require a congressional appropriation.²⁹ Similarly, the Air Traffic Organization charges fees for its services and keeps these funds rather than distributing them back to its home agency.³⁰ That inherently gives the executives running these offices greater autonomy. By contrast, FSA cannot charge fees or keep any revenue generated from its financial aid programs, making the office somewhat less independent and also more subject to the annual appropriations process.

The Patent and Trademark Office's main purpose is to review and approve patents and trademarks.³¹ This includes promoting intellectual property rights internationally and operating a trial and appeals board to handle disputes over rejected patents or disagreements among patent holders. But these legal proceedings typically involve private parties going to court—notably different than FSA, which is tasked with enforcing an expansive and complex government program.³²

The Air Traffic Organization, meanwhile, handles all U.S. air traffic services, including traffic control and airport terminal control.³³ These issues are more clear-cut than questions on what constitutes successful student loan repayment, making the PBO structure a natural fit for the objectives of the Air Traffic Organization. By contrast, complex issues about safety regulation, airport oversight, and certification are managed by other offices within Federal Aviation Administration.³⁴

FSA, on the other hand, combines extensive operational work with the oversight of the dollars it hands out. Not only does it ensure that financial aid reaches students on time, but it also monitors and enforces requirements related to an institution's eligibility for aid, such as whether it is abiding by rules for awarding and returning financial aid, properly compensating anyone who works in recruitment, and demonstrating financial responsibility.

Finally, FSA oversees a substantial amount of government spending but has a significantly smaller staff and operational budget than the other PBOs. FSA employs about 1,300 workers and has an operating budget of about \$1.7 billion.³⁵ That small staffing size reflects the fact that FSA outsources significant portions of its operations to contractors. For example, nearly half of its operating budget, or \$825 million, goes to student loan-servicing contracts.³⁶ It also has contracts for its major data systems and student loan debt collection.³⁷ By contrast, the Air Traffic Organization has about 35,000 employees and a budget of \$7.7 billion, and the Patent and Trademark Office has about 12,500 employees and a budget of \$3.5 billion.³⁸ That means FSA runs with a much leaner staff and operating budget.

The move to a PBO structure brought significant independence for FSA. The entirety of FSA moved out from under the Office of Postsecondary Education at the Education Department. This included all operational functions as well as components related to oversight of colleges and universities that receive federal aid.

The change also involved physical separation for FSA. The office moved out of the space it had shared with other parts of the Education Department and into its current location in a building near Union Station in Washington, D.C.³⁹ Though hard to quantify, this physical separation may also play a role in criticisms related to FSA's independence that overlap with the PBO structure. Regardless, the physical and organizational separations sent a clear message that FSA was to be a new and independent arm of the Education Department.

PBOs' purposes and structure

When Congress established FSA as a PBO in 1998, it listed a series of purposes for the office, which remain substantively unchanged today.⁴⁰ These items (listed below) reflect the concerns over operational issues that drove the structural change in the first place. For example, 5 of the 7 purposes emphasize issues such as the lack of integrated data systems; the need for lower program costs; and greater accountability for management.⁴¹ The purposes include:

- (A) to improve service to students and other participants in the student financial assistance programs authorized under title IV [the title of the Higher Education Act that covers the federal financial aid programs], including making those programs more understandable to students and their parents;
- (B) to reduce the costs of administering those programs;
- (C) to increase the accountability of the officials responsible for administering the operational aspects of these programs;
- (D) to provide greater flexibility in the management and administration of the Federal student financial assistance programs;
- (E) to integrate the information systems supporting the Federal student financial assistance programs;
- (F) to implement an open, common, integrated system for the delivery of student financial assistance under title IV; and
- (G) to develop and maintain a student financial assistance system that contains complete, accurate, and timely data to ensure program integrity.

Concerns with oversight of colleges in particular date back to original debates about what functions should or should not be moved to the PBO structure before the 1998 legislation passed. Ultimately, the Clinton administration and Congress opted to do what multiple interviewees referred to as a “lift and drop,” meaning that all of FSA’s functions moved to the PBO, including operational elements as well as over-

sight and program compliance responsibilities.⁴² At the same time, the legislation emphasized that the secretary of education was to maintain control of the policy and regulatory side of the student aid programs. FSA's role on those matters was to be consultative—providing advice and estimates as needed—while maintaining its operational and oversight responsibilities.

The decision to combine operations and oversight was controversial at the time. Some officials argued that the two should remain together because there was some overlap between the functions, and keeping in them under one roof would facilitate both roles.⁴³ Others argued that the PBO's emphasis on operational issues would detract from oversight; they said that the Education Department should handle oversight duties given that it would be directly accountable to political leadership. Observers today who raise concerns about FSA's oversight record would say that their arguments have been vindicated.

FSA's flexibilities as a PBO

The PBO structure makes FSA somewhere between a private business and a government office. The office receives some flexibilities intended to ease but not eliminate traditional federal rules around hiring, compensation, and procurement. (see Appendix for more detail) For instance, FSA can pursue easier hiring authority for a limited number of senior managers and pay them more than other federal employees but still well below comparable private sector levels of compensation. And while it has some paths to make procurement easier, the office can be and has been successfully sued for not following federal requirements around contracts.⁴⁴ It cannot, however, charge fees to generate revenue for the office and is entirely dependent upon Congress for its annual appropriation.

In exchange for these flexibilities, the office is bound to a five-year performance plan that guides senior leadership's work. FSA also must produce an annual report to Congress that tracks its progress toward goals.

Agency flexibility also applies to FSA's leadership. As a PBO, FSA is run by a COO who is appointed by the secretary of education for terms of three years to five years.⁴⁵ The COO can be removed only by the president or for cause, unlike a political appointee, whom the secretary could dismiss at her discretion. This shift makes the office's COO role more akin to a nonpolitical job such as director of the FBI or an inspector general than a typical political appointee who loses their job when

administrations change. In fact, policymakers established a five-year term for the COO so that it would overlap with four-year presidential terms, giving the position further independence as well as ensuring continuity in operations and allowing the COO to implement longer-term strategies. In exchange for these flexibilities, the COO enters into a contract that includes a performance agreement and expectations that are supposed to be mirrored in an overall strategic plan for the office. The education secretary holds the responsibility under law to develop the performance agreement for the COO.

FSA also operates outside of normal hiring and procurement rules, making it easier to attract senior-level employees and award contracts for data systems, debt collection, or student loan servicing. FSA's hiring flexibilities only extend to the COO and senior managers (roughly 50 people total) plus up to 25 people with specific technical or professional knowledge. These individuals can be chosen outside of the government's typical hiring process, which includes posting public job listings and requiring candidates to fill out lengthy questionnaires related to job knowledge, skills, and abilities that produce a rating of applicants that limits who can be considered for the position.⁴⁶

The PBO status also grants senior managers special compensation rules. The COO and other senior managers may be paid up to the maximum amount of the most senior career government officials' salaries, which was \$189,600 for 2019.⁴⁷ In addition, the COO may receive a bonus worth up to half of their salary, while senior managers can receive an amount of up to 25 percent of their base pay. In 2017, bonuses for most senior managers ranged from less than \$6,000 to \$25,000, with the median award for the highest performers falling just under \$10,000.⁴⁸ The annual report does not, however, disclose the overall average or median bonus for all individuals who received additional compensation. Senior managers have their own performance agreements that are developed in consultation with the COO.

The statute also lists several procurement flexibilities. In general, due to its status as a PBO, FSA is not required to follow traditional government rules for maintaining an open and competitive selection process for contracting.⁴⁹ For example, the office may use a two-stage process for soliciting outside contracts. This allows the office to start with a more typical procurement notice, then winnow that pool down under its discretion to a set of bidders that apply for a more specific set of requirements.⁵⁰ This process gives FSA more control over the number of final bidders that it considers as well as a more tailored procurement. The agency can also more easily choose a single company to award a contract to when it divides up a system into smaller pieces or

modules.⁵¹ These flexibilities, however, do not fully exempt FSA from all federal procurement requirements, and it has had to change major contracting competitions in the face of lawsuits.⁵²

Measuring FSA's performance as a PBO

In addition to individual performance contracts, FSA's PBO status requires the office to follow an overall performance plan.⁵³ This document is intended to cover the goals and objectives for FSA over a five-year period. FSA is supposed to develop the plan in consultation with stakeholders, including students, institutions of higher education, and Congress.

The most recent five-year performance plan for FSA covering fiscal years 2015 through 2019 shows how this performance concept works in practice.⁵⁴ The plan lays out five strategic goals for the agency with 16 subgoals and spells out 13 quantitative performance measures to track success on the goals. One strategic goal, for example, is to "improve operational efficiency and flexibility." The subgoals include objectives such as linking disparate data sets, refining how FSA does acquisitions, and strengthening information technology security. The strategic plan then quantitatively tracks performance toward these goals by looking at the per application cost for student aid delivery and the share of the student loan portfolio that is in active repayment.

Each annual report during this five-year period provides updates on progress for these goals, subgoals, and performance measures. For FY 2018, for example, FSA reported a cost of \$8.38 per application to disburse grants and loans, which was less than its own target of \$12.16 per application. Similarly, 86.5 percent of the portfolio is in an active repayment status, which was better than the target range of 85 percent to 86 percent. As a result, the agency reported that it met both metrics for this strategic goal.⁵⁵

Problems attributed to FSA's performance and PBO structure

In recent years, some observers in the policy community have come to view FSA's PBO status as a problem rather than a solution. These complaints tend to fit into 1 of 3 general categories: broad complaints about the office's performance problems; complaints that FSA has not followed specific PBO procedures; and complaints that the PBO structure actually works against transparency, accountability, and better program performance.

Allegation: FSA is not living up to expectations

The first category—which is by far the most sweeping and least defined—largely includes complaints that FSA has not lived up to the policy community's expectations. These critics point to almost any problem with the agency's operations or outcomes as evidence that FSA is ineffective. They imply that a PBO would carry out its operations flawlessly were its structural guidelines followed closely; that is, after all, why FSA has been designated a PBO. In other words, critics ask, what value does the PBO status provide if the office has operational problems?

Perhaps the best example of this type of critique came from the former chairman of the House Committee on Education and the Workforce, Rep. Virginia Foxx (R-NC), at a 2015 hearing about FSA's PBO status. In her opening remarks, she states:

Nearly two decades [after the PBO was created] and trillions of dollars later, many would argue FSA is not achieving the intended results ... Numerous reports reveal FSA is rife with inefficiencies that have led to a lack of communication with students, institutions, and loan servicers; improper payments; inaccurate reporting of data; failure to ensure borrowers are aware of the repayment options available to them; mismanagement of contractors and vendors; poor customer service—and I could go on, but we only have a limited time.⁵⁶

To sum up this line of argumentation, the problem is that FSA's special status as a PBO is supposed to make it more like a private business, yet its performance falls far short of what one would expect from a well-functioning private business.

Allegation: FSA falls short of how the PBO is supposed to operate

The second category of criticism about FSA's PBO status is more focused. These complaints point to a specific feature of the PBO where the office's actual practice has fallen far short of how the PBO is intended to operate. For example, critics might point to how FSA has failed to carry out the processes the statute requires such as developing and publishing five-year performance plans in a timely manner and with proper stakeholder consultation.⁵⁷ In other cases, FSA is accused of only perfunctorily engaging in the types of processes that are required of it. Some policymakers have also taken issue with FSA staff who continue to receive annual performance bonuses when the goals to which those bonuses are tied are vague or unmeasurable.⁵⁸ The implication of these concerns is that if FSA were to operate as Congress and others originally intended when they granted the office PBO status, then the programs that it administers would function more effectively and efficiently.

For instance, critics note that the agency's performance plans are stated in such simplistic and broad terms that no one can really determine whether or not the office accomplished them. The FY 2015 performance agreement for the COO—the most recently published agreement—demonstrates the management challenges that come from vague goals. The agreement lists goals such as “[a]nalyze current organizational alignment and re-define organizational structure and operating model as required to ensure achievement of FSA stated strategic objectives” or “[e]nsure that FSA's vision and strategy continues to map to the Department's objectives and make tactical adjustments as required.”⁵⁹ There are few additional details about the goals in these short documents, and they have become less specific with each subsequent performance agreement.⁶⁰

FSA's five-year plan has similar challenges. For example, 1 of 16 subgoals for the 2015 through 2019 strategic plan is to “[o]ptimize the borrower service model to improve the customer experience.”⁶¹ While that is a sensible and understandable goal, the lan-

guage indicating what steps FSA will take to accomplish this goal is less clear both in terms of objectives and management. After outlining efforts to date, the plan says:

In the future, FSA will further optimize its service model across the entire federal student aid life cycle, from initial outreach to final repayment. By simplifying customer facing processes, employing innovative communication strategies, and adding self-service options, FSA will be able to respond quickly to better serve the evolving needs of aid recipients and ensure that borrowers receive accurate, timely, and high-quality service on their federal aid.⁶²

This text raises several questions: What are the self-service options that should be available? What are the innovative communication strategies? How will FSA establish that any of these things worked?

Goals related to accountability and oversight are similarly imprecise:

FSA will continue to ensure that an effective internal control framework is in place across the organization and will monitor the Title IV loan and grant portfolio performance through further data gathering and analysis, taking action where appropriate. FSA will develop more integrated approaches to risk management that include managing potential vendor related risk across the student aid life cycle and systemic risks that may impact the federal student lending portfolio. Particular emphasis will be placed on the proactive identification of risks, through enhanced analytics and monitoring of customer feedback, before they materialize.

FSA's leadership then pairs these vague objectives with performance measures that do not always have a clear connection to the stated goals. For example, a performance measure related to the above goal on risk monitoring is the rate at which incorrect student aid payments occur and the share of borrowers who are more than 90 days late on their loan payments. Those are both useful indicators for judging the overall health of the aid programs, but it is unclear how improvements there will directly relate to achieving the objectives.

Criticisms about vague, unmeasurable goals are echoed in reports issued by the Government Accountability Office (GAO) and the Education Department's Office of Inspector General (ED OIG). The National Association of Financial Aid

Administrators raised many of these issues in its own 2017 report calling for reforms to the PBO structure.⁶³ The following passage sums up those criticisms:

In 2002, GAO noted recent FSA performance reports ‘do not include all the information specified by the legislation.’ Again, in 2004, GAO concluded FSA ‘plans and reports do not contain all the required information needed by the Congress and the public to assess FSA’s progress in achieving its goals and purposes.’ Then, in 2008, the ED OIG reported ‘FSA has not completely fulfilled its planning and reporting responsibilities, as required, and its planning and reporting processes are not always effective or efficient... FSA has not clearly informed Congress, the Secretary, or the public about its progress toward achieving its purposes as established by the HEA.’ Despite repeated criticism from these agencies, the same planning and reporting requirements still remain out of statutory compliance.

This critique asserts, in other words, that the problem is not the PBO status itself but rather whether or not FSA is abiding by all of its statutory requirements.

Allegation: The PBO’s independence works against transparency, accountability, and better performance

The third category of complaints claims that the PBO status itself is a problem. Compared with the other categories of concerns, which are related to how the PBO is falling short of achieving policymakers’ goals, this final type of complaint suggests that the PBO status allows FSA to set its own agenda instead of tackling problems that others in the policy community believe should be addressed.

This category of complaints is perhaps the most important for policymakers to understand and scrutinize because it could lead them to pursue more far-reaching reforms such as abandoning the PBO status altogether or dismantling some of its key features. If the reasoning behind these complaints is flawed or inaccurate, however, it could lead policymakers to needlessly eliminate the PBO structure while failing to solve the problems they aimed to address in the first place. Policymakers might then also risk reintroducing problems that the PBO was originally intended to address.

Those who think the PBO is the problem generally take issue with the agency’s stand-alone structure. In this view, FSA’s independence from the Education Department has resulted in operational problems with loan servicers, improper payments, inaccurate reporting, and poor customer service, among other issues. They

argue that this independence makes FSA less responsive to policymakers, including the secretary of education, political appointees, career staff in other parts of the department, and even Congress.

Independence and FSA's priorities

Mark Schneider, now the director of the Institute of Education Sciences at the Education Department, has made one version of the argument that FSA's structure and independence as a PBO allows it to not focus on some areas that others might want it to emphasize. In a 2017 *National Affairs* article, he wrote that the independence FSA gains as a PBO allows it to be unresponsive to requests from policymakers, including those at the department, for data on the performance of federal student aid programs such as the Federal Direct Loan Program. As Schneider explains:

[A]s a PBO, FSA has often been less than responsive to requests for data and research that would benefit the rest of the nation ... Its orientation is essentially that of a bank, focused solely on the administration of financial aid programs rather than reporting data or facilitating research.⁶⁴

Schneider is not alone in his views. The authors interviewed other individuals in the policy community who echoed his concerns. They felt that the independence PBO status granted FSA allowed the agency to ignore or assign a low priority to any requests for data or information about federal student aid programs. Schneider did not, however, suggest that the PBO structure was flawed; he simply proposed that lawmakers make data publication an explicit goal of the PBO.

Oversight of colleges and universities is another area where some critics argue that FSA's perceived lax performance results from PBOs' lack of explicit goals and requirements in this area. This oversight currently includes multiple forms of monitoring such as annual audits and program reviews that assess whether colleges and universities adhere to statutes, regulations, and rules.

None of the PBO's seven statutory goals explicitly mentions that FSA should have an oversight role, nor do any of the 13 quantitative performance measures that FSA used in its annual report.⁶⁵ To be fair, 3 of FSA's 16 qualitative subgoals reference steps to mitigate risk. But it is not clear how FSA judges success on those items or how that relates to the quantitative measures. If policymakers required the PBO to meet certain performance goals related to oversight of colleges and universities—akin to those that exist for data systems or application processing—then FSA might place a greater emphasis on tackling these challenges.

According to the HEA, FSA may limit, suspend, or terminate participation in the federal aid programs when audits, reviews, and other monitoring identify issues such as fraud, waste, or abuse.⁶⁶ Critics, however, say these activities are perfunctory or focus narrowly on accounting matters rather than larger risks.⁶⁷ For example, while FSA staff diligently enforce rules that hold colleges accountable for properly awarding federal aid and for returning funds when a student leaves school before the end of a term, the office has failed to take action when large colleges show signs of posing financial risks to taxpayers or widespread fraud. These critics argue that FSA could have acted more swiftly—and would have, had goals set through the PBO structure encouraged it to do so—to cut off aid and secure financial protection for taxpayers when Corinthian Colleges, ITT Technical Institute, and the Dream Center institutions shut down in recent years.⁶⁸

Independence and department policymaking

Some of the individuals with whom the authors spoke went much further in their concerns over FSA's independence and described core problems with the PBO structure. These observers suggested that the agency lacks sufficient oversight and is sometimes unresponsive to the department, Congress, and outside stakeholders in large part because FSA's COO is not a political appointee and can only be removed by the secretary of education if they fail to meet performance goals—a tougher standard than what applies to other political appointees at the department.⁶⁹ In their view, the independence allows FSA to brush off requests for information from political and career staff at the department. It also allows the COO to ignore guidance from outside political appointees regarding how FSA should administer student aid programs. If the head of FSA were instead a political appointee, they argue, he would have to be more responsive to the secretary of education and work to implement her agenda or risk being fired.

Ironically, the policymakers who originally developed the PBO were seeking to insulate the COO from political interference and guarantee that the COO would have the job security needed to carry out longer-term operational goals.⁷⁰ However, a major development during the Obama administration provides context for how some in the policy community today see FSA's independence as a complicating factor rather than a beneficial feature of its PBO status.

The lack of clear lines between what is policy—and thus in the realm of the department—and what is operations—meaning within FSA's purview—also lead to concerns about independence. When the PBO was created, policymakers sought to give FSA control over all operational duties in managing student aid programs (i.e.,

the business-like functions suited to a PBO structure) as well as oversight of the schools and lenders that participate in the federal aid programs. In the meantime, policymaking would reside strictly with the department's political appointees. The PBO design assumed that those two functions could be neatly separated, but actual experience illustrates that the distinction is not so clear.

The intermingling of operations and policy will continue to be a challenge going forward.⁷¹ The aid programs have increased in size and complexity since FSA's transition to PBO status, and with the move to direct lending, FSA has more direct responsibility for borrowers' repayment experiences. Meanwhile, the PBO structure places the decision-making authority regarding the program's operations squarely with FSA and its politically insulated COO.

The tension between FSA's operational separation and political independence is best illustrated by the department's attempt to award new student loan servicing contracts during the Obama administration. These contracts dictate standards for customer service that the private contractors that manage loan repayment on behalf of the department provide. This roughly \$1 billion investment thus has direct implications for how the more than 34 million borrowers with active federal loans held by the department will make payments, sign up for different repayment plans, seek relief when they are struggling, and avail themselves of other benefits that can keep them out of default and on a path to retire debts.⁷² As FSA worked through the process of renewing and replacing the set of contracts that would expire in 2019, an Obama administration appointee at the department, Under Secretary of Education Ted Mitchell, published a 51-page memo in 2016 to then-COO James Runcie stating the administration's policy preferences.⁷³

The so-called Mitchell memo is noteworthy on at least three dimensions. First, it speaks to the political buffer and independence of FSA. Rather than stating what policies the administration would be adopting, the memo instead provides "policy direction" and notes that the administration "look[s] forward to working with [FSA] in developing a servicing system consistent with the following policy direction." It is unusual for political appointees—the heads of their respective federal agencies—to issue this type of public communication and policy direction to other offices within the same agency. At other agencies, political appointees could make all of the necessary decisions and speak on behalf of the entire agency. But in the case of FSA, with its arm's-length separation from the department and its political appointees, the under secretary cannot simply dictate how the agency will administer the federal student loan program. Instead, part of his approach to influencing FSA must on some level be to persuade the COO to take the action he desires.

The memo also showcases the challenges the PBO status creates for the department when communicating with stakeholders and the public about FSA's actions. An executive branch agency that announces a new policy agenda would normally issue press releases and fact sheets to fully inform key audiences. But FSA's independence complicates that role. FSA controls the contracts for student loan servicers, which it is supposed to develop with independence from the department and political agenda. The memo occupies a middle ground that simultaneously lays out guidance for FSA and serves as the major public announcement of servicing reform for interested parties.

Issues around loan servicing also illustrate how it is often difficult to separate the operational functions at FSA from policymaking at the Education Department. For example, Congress and the executive branch set the terms and benefits in the federal student loan program, but FSA designs and enforces the contracts for the private companies it hires to administer those programs and shapes how those policies work on the ground. One section of the Mitchell memo sums this up well:

The incentives in the student loan servicing contract must drive servicers to take action that will result in the best outcomes for borrowers. In the past, the incentive structure in some contracts may not have optimally encouraged servicing entities to favor actions that maximized the benefits for borrowers ... Since the contracts were changed in September 2014 to deter the usage of forbearance, there has been a decline in the use of forbearance, and enrollment in income-driven repayment plans has steadily increased. We believe that it is important to incent servicers properly to help ensure that borrowers receive high-quality service, and that the current fee schedule has significant advantages over other servicing compensation models.⁷⁴

In other words, the Obama administration believed that FSA's servicing contract had favored one student loan benefit (forbearance) over another (income-based repayment) in a way that contradicted what the administration felt was optimal for borrowers. Program operations set in place by FSA's contracts with private servicers were working against the administration's policy preferences. The Obama administration could not, however, simply change the contracts to reflect those preferences when they were up for renewal. That is the purview of FSA and its COO who, by design, are insulated from political meddling in the day-to-day operations of the student aid programs. It is possible that was purpose of the independence and political insulation policymakers had in mind when they created the PBO in 1998. Nevertheless, many in the policy community seem more likely to view that independence as a problem rather than a solution.

Independence and FSA's relationship with Congress

While its PBO structure intentionally makes FSA more independent of the Education Department, that is not necessarily the case with FSA's relationship with Congress. The office still needs an annual appropriation from Congress to operate, and the amount of money it receives directly dictates what work it can accomplish and at what price. FSA cannot simply spend more on student loan servicing than it receives from Congress.

This means that when Congress is unsatisfied with FSA's performance or wants to change direction, it has leverage to do so through either changes to the HEA or other legislative vehicles such as appropriations bills. In the former case, that can mean higher-order changes such as altering the goals or purposes of the office. But Congress can also make much smaller and more specific changes such as creating new benefits on a tight timeline or changing direction on planned contract competitions. All of these changes can be—and often are—separate from the PBO structure and goals, cutting against the office's independence, and focus on performance metrics that are laid out in statute or strategic plans.

In recent years, Congress has been more willing to involve itself in very specific issues related to FSA, often through the appropriations process. This includes adding language dictating certain parameters and changes for ongoing attempts to write new student loan servicing contracts.⁷⁵ This language can cut in both directions, dictating requirements for more protections for borrowers or laying out requirements to provide accounts to servicers that might otherwise be excluded by Education Department actions.⁷⁶

These types of congressional actions are not inherently right or wrong—and they are certainly within the rights of the legislative branch. However, they deviate from the central premise of the PBO: The office should be granted flexibility and independence and then judged on a few key outcome metrics. Frequent legislative directives from Congress can challenge operations and performance with respect to the goals of the PBO if these directives cause FSA to redirect of resources or amend an ongoing operation.

Considerations for policymakers

Today, federal lawmakers are in a similar place to where they were 20 years ago when Congress converted FSA into a PBO. Growing concerns about student loan servicing and poor student loan repayment outcomes have led some to propose massive structural changes to FSA. Notably, some have proposed moving the entire office over to the Treasury Department.⁷⁷ While such significant restructuring may send political signals about the need for reform, policymakers and officials at the Education Department should take a more cautious approach grounded in the historical lessons of prior reforms. This is true both for lawmakers as they write legislation that affects the PBO's structure and goals as well as leaders at the Education Department who implement plans and goals to better manage FSA. While much of this guidance focuses on formal elements of managing FSA, policymakers should also acknowledge the importance of encouraging close, productive interpersonal dynamics between senior officials at the Education Department and FSA staff.

Recognize that the PBO works better when problems have clearer solutions

Congress turned to the PBO structure at a time when there were major operational challenges within FSA, including processing aid applications and preventing fraud, with relative success.

To address FSA's challenges in 1998, policymakers wanted to install leadership with a business background to improve the speed and efficiency of processing student aid applications and dispersing funds. Those challenges were largely addressed following the conversion to a PBO, and the federal student aid programs were removed from the high-risk list. The move to a PBO also coincided with improvements in FSA's data systems and financial aid processing.⁷⁸ In 2002, it produced a clean financial audit for the first time in several years.⁷⁹ While there is no available counterfactual to show whether or not those issues would have been fixed anyway, the problems that had long plagued FSA were largely reduced after establishing the PBO.

It is also worth understanding when the office's PBO status has worked particularly well for addressing challenges. FSA seemed to benefit most from its PBO status when it was facing clear crises or a set of objectives that are fully under its control. This includes data system integration and producing a clean audit along with other steps to get off the high-risk list.

The expansion of the federal loan program and the transition to direct lending during the Great Recession is also a challenge that the PBO appears to have handled well. That process had clear end goals: ensure that there was no interruption in loan availability; switch all colleges to direct lending; and handle a significant increase in loans originations. Although the transition to a direct lending system was not included in the five-year strategic plan for FSA, it was built into the COO's performance contract, and the office adjusted its work to meet that goal.⁸⁰ A review of the transition to the direct lending program by the department OIG found that FSA successfully modified contracts and processes to accommodate the switch and also extended technical assistance to colleges.⁸¹

By contrast, the solutions to FSA's problems today are less clear-cut than they were in the 1990s, complicating who is responsible for fixing them. While observers blame FSA—and by extension, the student loan servicers it hires—for low student loan repayment rates, there are a variety of reasons that lead students to not repay their debt, some of which are outside of FSA's control. For instance, FSA is one of several parties whose approval or disapproval can affect which colleges operate in the federal aid programs.⁸² Similarly, while FSA has control over the servicing contracts, there is no consensus within the policy community about whether borrowers should be pushed toward the plan with the lowest monthly payment or the plan that pays down their debt fastest. That will make it harder to define what success looks like in solving problems related to repayment.

Regularly assess if the PBO's goals are still the most relevant

The problems that FSA faces today differ from those in the late 1990s, when it was first established as a PBO. In order to address these issues effectively and efficiently, Congress must reexamine the goals set forth in statute and, if needed, provide revisions to ensure that the PBO's goals line up with FSA's current responsibilities.

Regularly assessing the problems that the PBO should focus on is a more effective management strategy going forward than criticizing FSA status for failing to address

challenges that the original statute did not anticipate. Policymakers should consider a clearer articulation of what problems—such as transparency, cost estimation, and oversight—they want the office to address today by changing the PBO goals.

Provide attentive oversight that is consistent with the PBO's structure

Congress and the administration must recognize that the PBO structure provides meaningful tools that can result in better performance for FSA operations. But it also gives the office independence that requires policymakers to be more vigilant when setting goals for the agency. Otherwise, that independence can frustrate the priorities of Congress and political leadership at the Education Department.

For one, that means political leadership at the department must seriously evaluate the performance plan and annual reports for FSA and the performance contract for the office's COO. Currently, many goals lack clarity on how they would be measured or accomplished, and they have become less specific over time.

Vague goals and unrelated outcomes measures make it difficult for the department to exercise proper oversight of FSA. Unclear performance expectations undermine the ability of the secretary to remove the COO for cause. Thoughtfully reviewing FSA's performance contracts, strategic goals, and annual report will make it easier to balance the department's political objectives with the daily operations at FSA.

Granted, there is no definitive way to know that more structured performance contracts and strategic plans would fix the challenges at FSA today because there are no historical examples of a PBO being faced with tightened performance goals. Multiple interviewees noted that the department has never fully leveraged the tools in the performance contract or strategic plan when working with FSA. While disappointing, this suggests that it would be worth exploring whether stronger management can make a difference before taking more extreme actions such as simply jettisoning the PBO structure.

A heightened focus on performance goals and annual reports would likely help improve oversight of the PBO, but interpersonal dynamics also matter. The physical separation of FSA from the rest of the department as well as its higher level of independence mean that it is crucial to establish good working relationships between FSA leadership and senior officials in the department. Multiple interviewees described how some of FSA's most successful years took place at times when

there was particularly good collaboration between the head of FSA and individuals running postsecondary education policy at the department. That means department leadership should be attuned to the quality of collaboration on postsecondary education issues and set expectations for how policy and operations will work together.

Understand when problems lie with the PBO or the department

It is important that policymakers know where the heart of a problem lies before they begin pursuing solutions. For example, some of the common concerns with the student aid programs can more fairly be attributed to the Education Department. Trying to address those items through the PBO, therefore, would not be particularly effective.

Cost estimation is an example of one such area. In recent years there have been significant concerns about the accuracy of what the department expects various parts of the student loan program will cost.⁸³ Responsibility for that improvement, however, mostly lies with the budget office within the department—not FSA. The budget office works with the Office of Management and Budget to produce annual estimates for the president’s budget request. That process relies on data extracted from FSA systems, but the methodology and issues related to it are not FSA’s responsibility. While it is possible that cost estimation could be improved with higher-quality data availability, focusing only on the PBO to address this challenge would be unlikely to fully solve the problem.

Consider how Congress interacts with the PBO

The legislative branch also has a role to play in properly managing FSA. It can dictate long-term goals through statutory changes and conduct regular oversight by reviewing annual plans, COO performance agreements, requesting documents, and holding hearings. But Congress should consider the implications when it gets involved in more specific issues with FSA. For example, appropriations language that creates new benefits with tight timelines or dictates the contours of contract competitions can affect timelines for completion or lead to a redirecting of resources from other areas. This is not to say that Congress should never consider changes at FSA outside of the authorizing process of a new HEA every decade or so. Rather, Congress must understand that its own actions with respect to FSA can affect the ultimate outcomes achieved on student loan repayment, the cost to make changes, or other key measures of success.

Conclusion

FSA's initial move to a PBO was borne out of a management crisis at the office. It was meant to help FSA restore the federal aid programs to good standing in the eyes of its auditors and government watchdogs. Many would argue that this solution worked, as the crisis was largely resolved following the conversion. More recently, FSA has successfully navigated other challenges such as the transition to a direct lending system, which greatly expanded the scope of FSA's operations. Both examples showcased what the PBO does best. There were clear end goals to meet even if the exact steps to get there were not clearly spelled out.

Today, FSA faces a different and arguably more complex set of challenges. The federal student aid programs are much larger, more complicated, and under more direct control of FSA. Meanwhile, policymakers are more interested in how these programs operate and perform.

As Congress works to reauthorize the HEA, it would be wise to learn from the past 20 years of FSA history when making any major policy decisions—instead of simply reaching for another massive structural change. Similarly, the Education Department must start acknowledging the importance of FSA through more meaningful and active management. The COO performance contract, strategic plans, and annual reports cannot be box-checking exercises or afterthoughts. Ensuring that the PBO is truly performance-based, with all the requirements for oversight and management that requires, is an important first step to guaranteeing that these programs achieve their intended aims.

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Appendix:

Greater detail on PBO flexibilities

Hiring

The PBO statute exempts senior managers in FSA from the hiring rules set by the Office of Personnel Management.⁸⁴ In general, the typical government hiring process includes things such as publicly posting job listings and requiring candidates to fill out a lengthy questionnaire related to job knowledge, skills, and abilities that produce a rating of applicants that limits who can be considered for the position.⁸⁵ Waiving these provisions means FSA can proactively seek out candidates and select from individuals whose backgrounds might not otherwise get through a standard hiring questionnaire.

In addition to the senior managers, the COO has similar hiring flexibilities for up to 25 individuals who have technical or professional knowledge to run the aid programs.

While these hiring flexibilities are significant, it is worth noting that they do not apply to the vast majority of FSA employees. In FY 2018, there were 44 senior managers in FSA plus another seven that have a separate governmentwide designation for being senior leaders in an organization.⁸⁶ It is unclear if these include the 25 technical and professional appointments. The rest of the nearly 1,300 FSA employees continue to be hired through the traditional process.

Compensation

The PBO statute also provides flexibilities related to compensation for the COO and senior FSA leadership. However, these pay flexibilities do not extend to all FSA employees. The COO and senior managers may be paid up to the maximum amount of the most senior career officials' salary, which was \$189,600 for 2019.⁸⁷ In addition, the COO may receive a bonus of up to half their salary as long as it does not exceed the president's annual compensation. This brings their total possible pay

to \$284,400 per year. By comparison, the education secretary's salary is capped at \$207,000.⁸⁸ The COO is also not subject to typical requirements that limit senior officials' salary at \$230,400, which is the level of the vice president.⁸⁹

FSA senior managers, meanwhile, can receive bonuses up to 25 percent of their base pay, bringing their total possible salary to \$237,000 per year. (The statute is not clear if their pay is capped at the vice president's salary.) Senior managers are not bound to normal requirements that tie career employee pay to a general schedule that consists of 15 different levels.⁹⁰ In 2017, bonuses for most senior managers ranged from less than \$6,000 to \$25,000, with the median award falling just under \$10,000.⁹¹ A smaller subset of eight senior managers were eligible for even larger bonuses of up to \$35,000.

Procurement

The PBO statute also grants FSA independent control of its procurements, theoretically limiting the ability of other parts of the Education Department to direct higher-profile contracts such as those for student loan servicers.

In general, the procurement flexibilities allow FSA to not follow traditional government rules for completely open and competitive selection processes.⁹² For example, FSA is only required to ensure that winning bidders have the "capacity and capability" to meet contract requirements.⁹³ This is less restrictive than broader contracting rules, which require vendors to meet a range of tests, including finances, performance record, as well as integrity and ethics. This could theoretically allow FSA to choose winning bidders who might not otherwise make it through a traditional process. That said, it is unclear the extent to which FSA does use this more limited focus in practice.

The second major procurement flexibility for FSA is to use a two-stage competitive bid process.⁹⁴ This allows FSA to first solicit vendors with a more typical procurement notice, then use its discretion to winnow that pool down as much as it wants to a subset that applies to a second set of more specific requirements. This gives FSA more control over the number of final bidders that it considers. According to one former senior manager in the agency, it also allows for writing more tailored procurement requests so that the agency can get what it wants.

Third, FSA has more flexibility to choose winning bidders when it divides a system into smaller pieces or modules. For instance, the office’s current proposal for redoing student loan servicing contains multiple different pieces. Once FSA awards the first part of the system, it can make subsequent awards to others who have already received past competitive contracts. It can choose a single company to win if it is the “most advantageous source.”⁹⁵ That is a much lower bar than normal procurements, which only allow choosing a single company if no one else can meet the requirements.

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