THE CHRONICLE OF HIGHER EDUCATION

Admissions & Student Aid

From the issue dated May 2, 2008

OPINION

A Design-It-Yourself Student-Loan Program

6 experts tell what they would do to build a new and better system

You don't NEED to be an expert on student aid to recognize that the current loan system is complex, sometimes inefficient, and highly politicized. When it comes to financing a college education, there is no one-stop shopping. Students and their parents have a multitude of lenders to choose from, including federal and state governments and colleges and universities, as well as private sources.

Adding to borrowers' woes is the fact that the subprime mortgage crisis has begun to bleed into the student-loan industry. The general credit crunch has already caused at least 50 lenders to pull out of the student-loan system altogether. Some financial-aid experts worry that the exodus may mean fewer loans available to students in the fall. We asked a handful of leaders in the student-aid debate this question: If you could design a new federal student-loan system from scratch, what would it look like? Here's what they came up with.

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Philip R. Day Jr.
President and chief executive of the National Association of Student Financial Aid Administrators

The united states is the richest, healthiest, and best-educated country in the world, right? Well, perhaps at one time, but no longer. The United States ranks fourth in GNP per capita, eighth in the number of people ages 25 to 34 with college degrees, and 37th among the world's health systems.

We're losing ground, and frankly that's unacceptable.

We talk about investing tax money to bolster health care, the military, and the national economy. We need to recognize that an investment in higher education is an investment in all of those areas. Medical research, military intelligence, economic growth — global competitiveness in virtually every area requires a well-educated, well-prepared citizenry.

Widespread education requires equity. Academic ability is not limited to high-income families, so why would we limit academic opportunity? Equity can be reached only by eliminating the barriers to education that confront many low-income and disadvantaged families: poor preparation for college, inability to meet educational costs, and complicated application processes.

At a minimum, equity in education requires that the first two years of postsecondary education should be available — free of cost — to the lowest-income students, based on a percentage of income above the poverty level. The federal Pell Grant maximum should be raised to at least a $10,000 entitlement and awarded on a sliding scale based on need. Significantly increasing the Pell Grant would combat overreliance on loans for the most disadvantaged students.

Low-income students who wish to attend higher-priced colleges would have access to subsidized loans to meet

their educational costs.

Poor preparation for college often makes it more difficult for low-income students to complete their academic programs. With front-loaded grants, low-income students would be able to attend college without debt, freeing them to aspire to higher levels of achievement. After the first two years, those students could borrow subsidized loans to meet educational costs if grant assistance were insufficient.

Determination of need should be based on income. Although not a perfect measure, adjusted gross income has proved to be the best indicator of a family's financial strength. A simple, annual measure of income would remove an additional barrier to education.

Grant amounts should decrease proportionately for families with higher incomes. These families would take out subsidized loans when income and savings were insufficient. Only those at the highest income levels attending high-cost colleges should need access to unsubsidized or private loans, or both.

When a student completes a baccalaureate degree, the federal subsidized loan principal should be reduced by 25 percent. For both undergraduate and graduate or professional students, 10 percent of the remaining balance would be forgiven annually if the student entered and remained in a high-demand profession (such as teaching mathematics or science).

That plan would provide the level of investment in education necessary to achieve our national priorities and regain our position as world leader.

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Brian K. Fitzgerald
Executive director, Business-Higher Education Forum, a nonprofit group of business leaders, college presidents, and foundation executives; and a former director of a federal committee that advised Congress on higher-education and student-aid policy

The most significant structural weaknesses in our current student-loan system are its complexity, inadequacy, and uncertainty. Student aid comes from a dizzying array of sources, including federal and state governments, institutions, and private sources, requiring student and parents to splice together a "package of aid" from these individual sources to cover the cost of college. Too much of that package consists of debt that shackles students, weighing on their careers and personal aspirations. Since no single source is responsible for supporting students, it is not surprising that the sum of all types of aid from all sources often falls short of the total cost of college, sometimes by thousands of dollars for low-income students.

The federal government should play a leading role in bridging those sources of aid, creating certainty years in advance of college enrollment, and ensuring that the aid will be adequate to pay for college.

One way to do that would be to create a new "College Access Account" — a flexible family line of credit (up to the cost of attendance), overlaying the complex patchwork of aid. Because this would be a line of credit, students or parents could go onto the Department of Education Web site and set up an account when their child is still in high school, for example. They could add the current tuition rates of colleges they are considering and begin to look at how they would pay for the cost of attendance.

The mix of loans, work study, and grants would be determined on an individual basis, with students getting "credits" against future debt (in the form of grants) for, say, taking a rigorous curriculum or having performed community service in high school, or majoring in high-need disciplines. And on-campus work could be matched with debt reduction.

The current aid process is opaque until parents open their aid-package letters. This new approach could allow parents and students to plan in advance, integrate the numerous sources of aid, and also encourage students to

prepare academically for college, as well as contribute to their community.

Such an account would be:

- Family- and student-centric.
- Designed to provide early and reliable information to enable academic and financial planning.
- Based on the total cost required to attain a two- or four-year degree.
- Adjusted appropriately (changing the mix from all loans to grants and work and loans, as necessary), according to all forms of need-based aid.
- Designed to have students work less at jobs while in college and encourage desirable activities.
- Tied fairly and efficiently to students' future earnings.

Using the account, families could build a college-financing strategy years in advance of enrollment and estimate their eligibility for various forms of aid, especially federal and state grants. Families could also have more flexibility to apportion debt between parents and students. Need-based grant aid and work would replace portions of the credit line. A portion could be subsidized student debt. Another could be federal unsubsidized loans or private loans to parents.

The impact of student-debt burden, which could increase under this approach, could be mitigated by expanding income-contingent repayment, which would help students who pursue lower-paying careers, like those in public serv-ice. In this form, a proposed College Access Account could improve access, enhance college success, and promote public service.

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Thomas J. Kane
Professor of education and economics, Graduate School of Education, Harvard University

Due to historical accident and lack of imagination, student-loan repayment has been modeled on private-loan repayment, with the same monthly payment schedule that is used for home mortgages and car loans. For consumer loans, a fixed payment schedule has advantages: It keeps the cost of capital low by providing investors with a regular, predictable stream of revenue; and it helps households to budget a known expense against a known income.

However, a college loan is fundamentally different. Most borrowers are clueless about their future income when they sit down to sign the promissory note. (Indeed, they may not even know whether they will major in history or accounting.) Moreover, for most people, the first decade after college brings huge changes in monthly income and expenditure needs. Agreeing to a fixed monthly payment with so much yet to be revealed requires a huge leap of faith — or desperation.

Moreover, a monthly payment schedule makes no sense for a government-backed loan. As long as the federal government is the source of capital, there is no cost saving from forcing students to make fixed monthly payments. Indeed, given servicing costs, it is more costly to hound students so frequently.

We should offer a new option: Rather than agree to a monthly payment schedule, borrowers would agree to pay a fixed percentage of their taxable income (depending upon the amount they borrow) until their loan is paid off. Currently, one's payment amount is certain, but one's income is not. Under this proposal, payments would automatically rise and fall with one's income. (That would expand an income-based repayment option that does exist in the federal program but is limited in availability and is generally directed toward borrowers who already have fallen behind in their payments.) The only uncertainty would be how long it would take to pay off the loan.

(To avoid scaring away borrowers with better earning prospects, such a program could not play "Robin Hood." Each borrower would pay no more than the capital and interest on his or her own loan.)

Rather than remembering to pay on a monthly basis (a challenge for any 23-year-old), borrowers would pay once a year when they submit their tax returns. To avoid an end-of-year surprise, borrowers could check a box on their tax-withholding form, notifying employers to withhold a little extra to ensure that they could make their loan payment.

Nevertheless, it might still be desirable to offer some relief to struggling borrowers, to encourage them to take the risk of trying college. One option would be to redirect the sizable subsidies currently covering borrowers' interest costs while they are in college. Because any subsidized-loan borrower receives them, the in-college interest subsidies do little to absorb risk. The same subsidies could be redirected to pay interest in those years when a borrower's income is insufficient to make the interest payment, so that such interest would not be capitalized into the loan. Alternatively, the subsidies could be used to forgive borrowers' loans after some maximum repayment period, like 25 years.

If we are going to relieve parental anxiety about paying for college, we need to change the way loans are repaid.

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Mark Kantrowitz
Publisher of FinAid and EduPASS, Web sites that provide student-loan information

The primary purpose of education loans is to provide families with cash-flow assistance. Few families can afford to write a check for the full amount when college bills arrive. Instead, education loans allow them to spread out the cost over an extended period of time.

Education loans do not otherwise enhance access to higher education. Cutting interest rates and fees and providing subsidized interest mainly helps students after they graduate. It would be better to have a single grant program to focus on access and a single loan program to focus on cash-flow assistance, rather than the current blended approach.

The education-loan system needs to be streamlined and simplified. All existing loan programs, including the Perkins, Stafford (subsidized and unsubsidized), Parent PLUS, Grad PLUS, and consolidation loans — which differ in terms of interest rates and fees, grace periods, whether the interest is subsidized or not, and whether the borrower is a student or parent — should be replaced with a single loan program. Call it the Stafford PLUS loan. That loan would have an annual limit of the cost of attendance minus other aid received. (College financial-aid administrators would have broad authority to limit excessive borrowing depending on a student's major or type of degree.) The maximum interest rate on the loan would be an approximately revenue-neutral 7 percent, with a 1-percent default fee, a 1-percent origination fee, and a 0.25-percent interest-rate reduction for auto-debit. Eligible borrowers would include undergraduate students, graduate students, and parents of dependent undergraduate students. Parents could co-sign their children's loans for a waiver of the default fee. There would be no credit check, not even for an adverse credit history. However, borrowers who had defaulted on their federal education loans within the last five years would be ineligible for more education loans unless they cured the default.

Payments of principal and interest could be deferred during the student's (or borrower's) in-college period and the six-month grace period after graduation, capitalized once at repayment. Borrowers could also opt to make payments of principal and interest or interest only during the in-college and grace periods. Interest would be unsubsidized. The definition of the in-college period would include medical and dental residencies and internships. There would be an economic-hardship deferment as well as the current set of discharges, which are provisions for writing off the loan balance in certain cases — for instance, if a college closed suddenly.

Borrowers could choose from one of three repayment programs: standard 10-year repayment (the default

choice), extended repayment (up to 25 years), and income-based repayment. They could switch plans once a year.

Borrowers would also be provided with a one-time opportunity to refinance their loans, provided that they moved all loans to a single lender. Since that would not change the cost of the loan, the purpose would primarily be to provide the borrowers with a single monthly bill and give them an opportunity to switch lenders. There would be no fees associated with this refinance, not even a lender-paid origination fee.

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Brett E. Lief
President, National Council of Higher Education Loan Programs, an organization representing lenders

A federal student-loan program created from scratch could include four ingredients, all beginning with "F": foundation, focus, federal role, and financing sources. With these key ingredients, students and families would get the money they need, and colleges would get the support they require. Here is the basis for that program:

Foundation:
The foundation of the program rests on features that limit the amount students would need to borrow. There must be incentives to encourage families to participate in savings and tuition-prepayment programs, the assurance of a strong Pell Grant program for students from low-income backgrounds, and the promise of enriched campus-based work programs and loans for students from middle-income families.

Focus:
An ideal federal student-loan program would focus on the student, borrower, and college. Colleges should be empowered to provide a line of credit to students and award loans based on the total demonstrated financial need of the borrower and his or her family and on their special circumstances. To legislatively set the maximum amount students can borrow is confining and does not recognize those who fall outside of set parameters. Colleges should be permitted to use professional judgment to offer more aid when it is needed and documented. Once repayment begins, plans should be geared to a borrower's total financial circumstances and adjusted accordingly. Today's automation does not require a one-size-fits-all approach.

Federal role:
The federal role is critical and should enhance the nation's higher-education needs and update student-loan programs to better serve students. Congress should enact laws that fulfill the public policy of providing low-cost loans that complement a strong set of grant programs to make postsecondary education more affordable. It should also enact laws that encourage private and state participation while ensuring that underlying funds are available to meet policy objectives.

The Department of Education should share financing and administration of the program with entities that can finance and administer the loan programs in line with Congressional policy. Its role as regulator is to clarify, not pre-sent "de facto" law. In addition, it should provide research and data analysis to assess the higher-education enterprise and the continuing efficacy of the student-loan program. Finally, it should have an ombudsman to adjudicate conflicts between borrowers and program administrators.

Financing sources:
Financing for this program should be a collaboration between nonprofit and for-profit capital providers and the government, with the government serving two functions. The first is that within a single federal student-loan program, the government should become an eligible lender and not the administrator of a second program that increases complexity, cost, confusion, and possibly liability for students, families, colleges, and taxpayers. The second is that it should provide a backstop if money becomes constrained, and to meet unexpected needs.

Having that comprehensive infrastructure for a single federal student-loan program would increase efficiencies, improve services, and reduce costs. It is the best way to do business and deliver the best results. It focuses on

students and borrowers and would allow them to pursue their postsecondary goals to the best of their ability.

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Barmak Nassirian
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Today's student-loan programs exemplify how incoherent execution can frustrate sound policy goals.

The original logic of the federal loan program — that the federal government can enable needy borrowers to obtain credit to invest in themselves — remains compelling. That core rationale, however, has been co-opted by various constituencies, resulting in a financing system that suffers from three fatal flaws: unjustifiable complexity, substantial waste and mistargeting of subsidies, and overreliance on politics in lieu of market forces.

Any utopian federal student-loan program would first articulate its policy objectives with specificity, and then focus on the most efficient way to implement them. If the goal were to promote broad access to higher education for all qualified aspirants, here is how to reconfigure a more efficient set of loan programs:

- Settle the direct/guaranteed loan debate by creating one loan program in which the Department of Education and banks could participate as eligible lenders on an identical basis.
- Simplify by eliminating unnecessary actors from the loan process. Remove useless entities like guarantee agencies, which have written themselves legislative sinecures in the program. Other participants, like state-affiliated secondary markets, should also be either eliminated or forced to play by the same rules as comparable free-market providers.
- Depoliticize the operational features of the program. Payments to lenders, for example, should be priced by the markets, not by politicians.
- Rationalize the interest rates for loans. Instead of picking a fixed rate out of thin air through the political process, student loans should carry a variable interest rate just enough below market rates to be both sustainable from a federal cost perspective and attractive from the borrowers' point of view.
- Improve integrity by disqualifying shoddy colleges from the loan programs. Colleges with large proportions of borrowers whose incomes prove insufficient to reasonably cover their loan payments should be barred.
- Eliminate the in-college interest subsidy. A disproportionate amount of current loan subsidies are directed toward students who stay at institutions for long periods in pursuit of advanced degrees. While some of those borrowers may in fact need the in-college subsidy, it is overly generous for the majority of such borrowers, who actually do better in terms of postgraduation income than those with less education. The in-college subsidy also directs a disproportionate amount of federal dollars to higher-income students who attend more-expensive institutions.
- Get rid of defaults due to inability to pay. That is, do not allow government-guaranteed defaulted loan debts to accumulate in cases where the borrower has a demonstrated inability to repay.

The savings from cutting the in-college subsidy and better program integrity could be used to create a genuine safety net for borrowers whose postgraduation income proves insufficient to service the debt they have assumed. While several attempts at such a repayment system are already in the law, they are layered on top of a confusing array of repayment options whose relative merits few can understand.

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Volume 54, Issue 34, Page B22

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