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KEEPING COLLEGE WITHIN REACH: EXAMINING OPPORTUNITIES TO STRENGTHEN FEDERAL STUDENT LOAN PROGRAMS

HEARING

BEFORE THE

COMMITTEE ON EDUCATION
AND THE WORKFORCE
U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED THIRTEENTH CONGRESS

FIRST SESSION

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C O N T E N T S

	Page
Hearing held on March 13, 2013	1
Statement of Members:	
Kline, Hon. John, Chairman, Committee on Education and the Workforce	1
Prepared statement of	3
Miller, Hon. George, senior Democratic member, Committee on Education and the Workforce	4
Prepared statement of	5
Statement of Witnesses:	
Delisle, Jason, director, Federal Education Budget Project, New America Foundation	13
Prepared statement of	14
Draeger, Justin S., president and CEO, National Association of Student Financial Aid Administrators (NASFAA)	25
Prepared statement of	27
Lucas, Deborah, Sloan distinguished professor of finance, Massachusetts Insititute of Technology	8
Prepared statement of	9
Mercer, Charmaine N., Ph.D., vice president of policy, Alliance for Excellent Education	37
Prepared statement of	39
Additional Submissions:	
Bonamici, Hon. Suzanne, a Representative in Congress from the State of Oregon, letter, dated January 23, 2012, from Robert D. Reischauer	71
Mr. Delisle, response to question submitted for the record	81
Mr. Draeger:	
Report, "Reimagining Financial Aid to Improve Student Access and Outcomes," Internet address to	78
Report, "Report of the NASFAA Task Force on Student Loan Indebtedness," Internet address to	79
Report, "Report of the NASFAA Award Notification and Consumer Information Task Force," Internet address to	79
Response to questions submitted for the record	79
Grijalva, Hon. Raúl M., a Representative in Congress from the State of Arizona, questions submitted for the record to Mr. Draeger	79
Hudson, Hon. Richard, a Representative in Congress from the State of North Carolina, questions submitted for the record to:	
Mr. Draeger	79
Mr. Delisle	81
Chairman Kline:	
Prepared statement of the Education Finance Council	77
Mr. Miller:	
Memo, dated March 12, 2013, from the Associated Students of Michigan State University	47
Memo, dated March 12, 2013, from Emily Yu, president, American University Student Government	48
Statement of the National Campus Leadership Council: "Summary of Student Perspectives on Student Loans"	48
Roby, Hon. Martha, a Representative in Congress from the State of Alabama, questions submitted for the record to Mr. Draeger	79

KEEPING COLLEGE WITHIN REACH: EXAMINING OPPORTUNITIES TO STRENGTHEN FEDERAL STUDENT LOAN PROGRAMS

Wednesday, March 13, 2013
U.S. House of Representatives
Committee on Education and the Workforce
Washington, DC

The committee met, pursuant to call, at 10:03 a.m., in room 2175, Rayburn House Office Building, Hon. John Kline [chairman of the committee] presiding.

Present: Representatives Kline, Petri, Foxx, Roe, Walberg, Salmon, DesJarlais, Roby, Heck, Brooks, Hudson, Miller, Andrews, Scott, Hinojosa, McCarthy, Tierney, Holt, Davis, Grijalva, Bishop, Loebsack, Courtney, Fudge, Polis, Wilson, and Bonamici.

Staff present: Katherine Bathgate, Deputy Press Secretary; James Bergeron, Director of Education and Human Services Policy; Heather Couri, Deputy Director of Education and Human Services Policy; Amy Raaf Jones, Education Policy Counsel and Senior Advisor; Nancy Locke, Chief Clerk/Assistant to the General Counsel; Brian Melnyk, Professional Staff Member; Krisann Pearce, General Counsel; Mandy Schaumburg, Education and Human Services Oversight Counsel; Nicole Sizemore, Deputy Press Secretary; Emily Slack, Legislative Assistant; Alex Sollberger, Communications Director; Alissa Strawcutter, Deputy Clerk; Aaron Albright, Minority Communications Director for Labor; Tylease Alli, Minority Clerk/Intern and Fellow Coordinator; Kelly Broughan, Minority Education Policy Associate; Jody Calemine, Minority Staff Director; Jamie Fasteau, Minority Director of Education Policy; Scott Groginsky, Minority Education Policy Advisor; Brian Levin, Minority Deputy Press Secretary/New Media Coordinator; Rich Williams, Minority Education Policy Advisor; and Michael Zola, Minority Senior Counsel.

Chairman KLINE. A quorum being present, the committee will come to order. Good morning and welcome to our hearing. This is the third of a series we began last Congress to discuss ways institutions, states, and leaders in Washington can work together to help more students access an affordable college degree.

We are fortunate to have a distinguished panel of higher education experts here today and I would like to thank each of you for joining us.

Last summer, debate about student loans reached a fever pitch thanks to a scheduled increase in the interest rate for subsidized

Stafford Loans made to undergraduate students. The President began touring college campuses, calling on Congress to prevent the increase, frankly, that his own party set in motion back in 2007.

As I said at the time, no one wants to see student loan interest rates increase, particularly as young people continue to struggle with high un- and underemployment. But we need to move away from a system that allows Washington politicians to use student loan interest rates as bargaining chips, creating uncertainty and confusion for borrowers.

When Congress approved legislation to temporarily stave off the Stafford Loan interest rate increase, my colleagues and I lent our support with the promise that we would use this time to work toward a long-term solution that better aligns interest rates with the free market.

Today's hearing provides an opportunity to explore the merits of a market-based system. As many of you are aware, such a system was previously in place from 1992 through 2005. Had it remained, interest rates on student loans could be less than 3 percent today.

In addition to our discussion on student loan interest rates, we must also begin a larger conversation on the state of federal student aid programs as a whole. Supporting higher education remains a top priority in Washington.

Each year, taxpayers dedicate billions of dollars to help students afford to attend the college of their choice. In the 2011-2012 school year, students received more than $237 billion in aid, of which the federal government provided nearly $174 billion.

Given this significant investment, it is troubling to learn students struggle to navigate the various federal student aid programs available to help them pay for college. More work must be done to help students and families understand the federal student aid system and make informed choices about their higher education options.

Congress has a responsibility to explore ways we can strengthen and streamline federal student aid programs, making the process simpler for students, institutions, and families.

In his fiscal year 2013 budget request, President Obama proposed a number of initiatives affecting federal student aid programs, including a plan to change how three campus-based aid programs—Supplemental Education Opportunity Grants, Perkins Loans, and Work-Study—are distributed to shift funds away from institutions where the administration believes tuition is too high.

While my Republican colleagues and I continue to support the basic principles of competition and transparency to help encourage lower costs in higher education, we remain concerned that such policies could lead to federal price controls and more confusion for institutions and borrowers.

Though we are still waiting for the President's delayed fiscal year 2014 budget proposal, I hope the administration will abandon these previous proposals and instead illustrate a willingness to work with Congress to improve existing programs while demanding states and institutions do their part to tamp down college costs.

Before I yield to the senior Democratic member of the committee, Mr. Miller, I would be remiss if I didn't note my continued concerns with the Department of Education's management of the Direct

Loan program, which is responsible for the implementation and repayment of all federal student loans.

Borrowers continue to report a range of problems, including missing financial information, unexpected changes to loan amounts, poor customer service, difficulty rehabilitating loans, and data breeches.

The committee has been working with the Government Accountability Office to investigate some of these issues, and I hope we are able to solve some of these problems as we move into the reauthorization of the Higher Education Act.

With that said, I look forward to a productive discussion with my colleagues and our witnesses on proposals to improve and simplify federal student loan programs.

I now recognize Mr. Miller for his opening remarks.

[The statement of Chairman Kline follows:]

Prepared Statement of Hon. John Kline, Chairman, Committee on Education and the Workforce

Last summer, debate about student loans reached a fever pitch thanks to a scheduled increase in the interest rate for subsidized Stafford Loans made to undergraduate students. The president began touring college campuses, calling on Congress to prevent the increase that his own party set in motion back in 2007.

As I said at the time, no one wants to see student loan interest rates increase, particularly as young people continue to struggle with high un- and underemployment. But we need to move away from a system that allows Washington politicians to use student loan interest rates as bargaining chips, creating uncertainty and confusion for borrowers.

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In addition to our discussion on student loan interest rates, we must also begin a larger conversation on the state of federal student aid programs as a whole. Supporting higher education remains a top priority in Washington. Each year, taxpayers dedicate billions of dollars to help students afford to attend the college of their choice. In the 2011-2012 school year, students received more than $237 billion in aid, of which the federal government provided nearly $174 billion, or 73 percent.

Given this significant investment, it is troubling to learn students struggle to navigate the various federal student aid programs available to help them pay for college. More work must be done to help students and families understand the federal student aid system and make informed choices about their higher education options. Congress has a responsibility to explore ways we can strengthen and streamline federal student aid programs, making the process simpler for students, institutions, and families.

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While my Republican colleagues and I continue to support the basic principles of competition and transparency to help encourage lower costs in higher education, we remain concerned that such policies could lead to federal price controls and more confusion for institutions and borrowers.

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Education's management of the Direct Loan program, which is responsible for the implementation and repayment of all federal student loans. Borrowers continue to report a range of problems, including missing financial information, unexpected changes to loan amounts, poor customer service, difficulty rehabilitating loans, and data breeches.

The committee has been working with the Government Accountability Office to investigate some of these issues, and I hope we are able to solve some of these problems as we move into the reauthorization of the Higher Education Act. With that said, I look forward to a productive discussion with my colleagues and our witnesses on proposals to improve and simplify federal student loan programs.

Mr. MILLER. Thank you very much, Mr. Chairman, and thank you for holding this hearing on student loans.

Today more than ever higher education is viewed as a pathway to middle-class jobs and economic security. A college degree plays a critical role in most American dreams.

Unfortunately, we know all too well about the rising costs of higher education is pushing those American dreams a little bit further out of reach for too many families.

The rising costs are due to a number of factors. States' falling support for higher education has caused tuition to go up well above inflation. Many of us in this committee can remember the days when a decent higher education was well within the reach of average working families.

But this is no longer true. Higher education costs have been shifted increasingly to students and families. And to make matters worse, families' incomes have not kept pace with rising costs.

When workers incomes were growing with their productivity, parents could afford to contribute to the education of the children, but this too is fast becoming a thing of the past.

To make up most of this shortfall, students and parents turn to loans in order to pay for college. As a result, the average student now graduates $26,000 and that in the Consumer Financial Protection Agency tells us that there is over $1 trillion in debt out of the streets. This is higher than the nation's total credit card debt.

Just last week we had yet another report from the New York Federal Reserve on the impact of rising student loan debt on the economy. It found that student loan debt is almost tripled in the last 8 years as more students need to borrow more money to go to college and it is simply unsustainable.

Students who did everything that was asked of them are rightly concerned about their future. They wonder whether borrowing all of that money to get a degree is worth the trouble. Repaying their student loans has become a tremendous financial obstacle to making other life decisions.

It affects where they can work, whether they can ever dream of saving enough money to purchase a home, whether they will be able to afford to take the risk of starting a business, or should they just get married—or whether they should get married and start a family. In short, student debt can become a very serious drag on the economy.

This isn't just young people borrowing, either. Those 40 and older hold 34 percent of our nation's student loan debt. Older borrowers may be forced to delay savings for their child's education or for their retirement.

Falling behind on monthly payments will scar borrowers' credit ratings and open the door to wage, Social Security, and tax-refund garnishments. This debt threatens the very upward mobility of higher education once guaranteed.

A few years ago, Congress took significant steps forward in helping students and families deal with these realities and to afford an education, but those were just the first steps. There is more that needs to be done in short and long term to make college affordable, accessible, and to make student aid programs work better.

Members of both sides of the aisle should work together to develop these solutions. In the short term, while the economic recovery remains fragile, this committee must make sure that student loan interest rates do not double on students this summer.

On July 1, the subsidized Stafford loan interest rates will double to 6.8 percent for millions of undergraduate students if Congress does nothing. With the job market still recovering, we should not be asking students with the greatest need to be burdened by higher loan costs.

Interest rates for banks are at a historic low. In a sense, they are getting free money and there is no good policy reason why to allow rates for students to double at this time.

In the longer term, we need to consider new ways to calculate interest rates for federal student loans. There are a number of proposals that have been put forward, and we will hear more this morning, that we should examine.

Also, we must not ignore the problems of the private loan market. These rates are higher. Refinancing can be next to impossible and borrowers do not enjoy access to various repayment options that we provided to help borrowers pay for their loans.

We also should consider various solutions. As we do so, we must not lose sight of the fact that the borrowers are our nation's future.

I look forward to hearing from our witnesses on the way Congress can work together to address the interest rate question and reduce student loan debt.

I would also suggest that, Mr. Chairman, you and I have had a number of conversations about we are trying to make college more affordable, but we have to sometime get the colleges in here to tell us how they are going to reduce the cost of education, and there is a lot of things coming on the horizon now with online courses and massively-sized online courses.

I see in my state legislation in California they are about to introduce legislation that they think is going to pass that suggests that these online courses in fact be given credit so that students can save money by participating in that and reduce the cost of education and money they have to borrow.

So I think there's a lot we need to have a conversation with the colleges and universities about in this question of the cost of college. We have dealt long and hard with the affordability of it but we are running out of tools. Thank you.

[The statement of Mr. Miller follows:]

Prepared Statement of Hon. George Miller, Senior Democratic Member, Committee on Education and the Workforce

Good morning, Chairman Kline. Thank you for holding this hearing on student loans.

Today, more than ever, higher education is viewed as the pathway to a middle class job and economic security. A college degree plays a critical role in most American Dreams.

Unfortunately, we know all too well that the rising cost of higher education is pushing those American Dreams a little further out of reach for too many families. This rise in costs is due to a number of factors.

States' falling support for higher education has caused tuition to go up well above inflation. Many of us in this committee can remember the days when a decent higher education was well within reach for average working families.

Thanks to significant state support for higher education, credit hours were affordable. A summer job could be enough to help us get through the following year. But this is no longer true. Higher education costs have been shifted increasingly to students and families. And to make matters worse, families' incomes have not kept pace with this rising cost.

When workers' incomes were growing with their productivity, parents could afford to contribute to the education of their children. But this, too, is fast becoming a thing of the past.

To make up for this shortfall, students and parents turn to loans in order to pay for college. As a result, the average student now graduates with $26,000 in debt. And that debt looks more like a mortgage if a student goes on to attend graduate or professional school.

Last year, the Consumer Financial Protection Bureau found that student loan debt was more than $1 trillion. This is higher than the nation's total credit card debt. Just last week we had yet another report from the New York Federal Reserve on the impact of rising student loan debt on our economy. It found that student loan debt has almost tripled in the last eight years as more students need to borrow more money to go to school.

This is unsustainable. Students who did everything that was asked of them are rightly concerned about their future. They wonder whether borrowing all that money to get a degree was worth the trouble. Repaying their student loans has become a tremendous financial obstacle to making other life decisions.

It affects where they can work, whether they can ever dream of saving enough money to purchase a home, whether they can afford to take a risk and start a business, or when they should get married or start a family.

It isn't just young people borrowing either—those 40 and older hold 34 percent of our nation's student loan debt. Older borrowers may be forced to delay saving for their child's education or their retirement. Falling behind on monthly payments will scar a borrower's credit rating and open the door to wage, Social Security, and tax refund garnishment. This debt threatens the very upward mobility that higher education once guaranteed.

A few years ago, Congress took significant steps forward in helping students and families deal with these realities and afford an education. But those were just the first steps. There is more to be done in the short and long term to make college affordable, accessible, and make student aid programs work better.

Members from both sides of the aisle should work together to develop and move those solutions. In the short-term, while the economic recovery remains fragile, this committee must make sure student loan interest rates do not double on students this summer.

On July 1, the subsidized Stafford loan interest rate will double to 6.8 percent for millions of undergraduate students. With the job market still recovering, we should not be asking students with the greatest need to be burdened by higher loan costs. Interest rates for banks are at historic lows. There is no good policy reason to allow rates for students to double at this time.

In the longer term, we need to consider new ways to calculate interest rates for federal student loans. There are a number of proposals that have been put forward that we should examine.

Also, we must not ignore problems in the private student loan market. There, rates are higher. Refinancing can be next to impossible. And borrowers do not enjoy access to various repayment options that we have provided to federal loan borrowers.

As we consider various solutions, we must not lose sight of the fact that these borrowers are the nation's future. If they are shackled by unmanageable debt, our economy will invariably suffer. We have a moral and economic obligation to ensure that all qualified students who want to attend college can afford to go.

Our ability to compete in the global marketplace depends on it. I look forward to hearing from our witnesses on ways Congress can work together to address the interest rate question and reduce student loan debt.

Thank you for joining us today. I yield back.

Chairman KLINE. I thank the gentleman, and I agree with that comment.

As the gentleman knows, we have been looking at that. We have had a number of experts come in and talk to us. We are going to continue that dialogue and I am confident that will be in a bipartisan way as we explore the technology explosion that is so impressive and there is no way that we, Washington, can keep up with that. They are just going to move faster than we can. But there is work to be done there——

Mr. MILLER. Faster than us?

Chairman KLINE. Faster than us. I know, it is shocking. Shocking concept I know.

Pursuant to committee Rule 7C, all committee members will be permitted to submit written statements to be included in the permanent hearing record and without objection, the hearing record will remain open for 14 days to allow statements, questions for the record, and other extraneous material referenced during the hearing to be submitted in the official hearing record.

It is now my pleasure to introduce our distinguished panel of witnesses. Dr. Deborah Lucas is the Sloan Distinguished Professor of Finance at the Massachusetts Institute of Technology's Sloan School of Management.

Mr. Jason Delisle serves as the director of the Federal Education Budget Project at the New America Foundation. Previously, Mr. Delisle was a senior analyst on the Republican staff of the Senate Budget Committee and from 2000 to 2006 he was a legislative aide in the office of Mr. Thomas Petri who will be joining us shortly.

Mr. Justin Draeger is the President and CEO of the National Association of Student Financial Aid Administrators. Prior to joining NASFAA—I don't know who invents these acronyms—in 2006, Mr. Draeger served as a financial aid director at the Douglas J. Aveda Institute in East Lansing, Michigan.

And Dr. Charmaine Mercer joined the Alliance for Excellent Education in June 2012 as Vice President of Policy. Prior to joining the Alliance, Dr. Mercer worked for the House Education and Workforce Committee under Mr. George Miller on elementary and secondary education issues.

And while this is truly a distinguished panel, I have to say that it is especially distinguished having former key staff.

So, before I recognize each of you to provide your testimony, let me briefly explain our lighting system.

You will each have 5 minutes to present your testimony. When you begin, the light in front of you will turn green. When 1 minute is left, the light will turn yellow. When your time is expired, the light will turn red. At that point, I ask you to please wrap up your remarks as best you are able.

After everyone has testified, members will each have 5 minutes to ask questions of the panel and I would remind my colleagues that that 5 minutes includes the answers of our witnesses.

I would now like to recognize Dr. Lucas for 5 minutes.

STATEMENT OF DR. DEBORAH J. LUCAS, SLOAN DISTINGUISHED PROFESSOR OF FINANCE, MASSACHUSETTS INSITITUTE OF TECHNOLOGY

Ms. LUCAS. I am happy to testify on this important issue.

I want to focus on several programmatic changes that may seem technical in nature, but that are likely to yield significant benefits to students and taxpayers, and the budget.

A critical issue is what the rule should be that determines the interest rates charged to borrowers. As you know, interest rates on student loans are set in statute. Those rules have been changed numerous times throughout the history of the programs including shifting between fixed interest rates and variable interest rate formulas.

Since 2006, new Stafford loans have carried a fixed interest rate of 6.8 percent. The rate on subsidized loans is fixed at 3.4 percent, but that rate is scheduled to increase to 6.8 percent for loans made after the end of June.

The current practice of setting fixed interest rates that extend many years into the future—rather than linking them by formula to prevailing market interest rate conditions—has adverse consequences for students, for taxpayers, and for the stability and control of budgetary costs.

For students, the current policy creates large swings in the value of government assistance from year-to-year; very similar students that attend the same school but in different years receive very different amounts of support. Subsidies are small when interest rates are low as they are now and large when rates are high.

As well as raising fairness concerns, this volatility makes it more difficult for prospective students to assess the affordability of pursuing a higher education.

At the same time, the variability in year-to-year subsidies creates potentially large and uncertain liabilities for taxpayers, and from a budgeting and control perspective, the uncertain size and volatility of subsidies over time is detrimental to budgetary planning, and it has the effect of reducing the control that Congress exercises over the allocation of scarce budgetary resources.

Adopting the alternative of market-indexed rates would reduce the volatility in subsidies for borrowers and taxpayers and also help to stabilize the budgetary costs of the programs.

Under that approach, the interest rate charged on new loans each year would be linked to a market rate; for instance, to a Treasury security with a similar duration to the loans. The interest rates could still be fixed over the life of an individual loan, but that fixed rate charged to new borrowers would vary year-to-year.

Alternatively, borrowers could be charged a floating rate that resets every year over the life of the loan as was the case before 2006.

The notion that allowing interest rates to vary with market conditions would create greater stability and fairness than fixing interest rates by statute may at first seem unintuitive.

However, market-linked interest rates are beneficial because they generate more stable real, or inflation-adjusted, loan payments. High nominal interest rates generally coincide with periods of high expected inflation rates.

Market rates increase because investors need more compensation just to maintain the purchasing power of the loan repayments they receive. At the same time, wages grow more quickly during periods of higher inflation, making higher nominal payments more affordable to borrowers.

Furthermore, low nominal interest rates tend to be a symptom of a weak economy and job market, as is the situation today. Fixing the interest rate by law tends to shrink government subsidies at just those times when students would benefit from them the most.

With market-indexed interest rates, the generosity of subsidies could be controlled by choosing an appropriate interest rate spread; a number which could be specified in legislation in place of the fixed interest rates that are there today.

Because of the way student loans are budgeted for, moving to indexed rates would have the effect of lowering the volatility of their budgetary costs over time.

Specifically, under the Federal Credit Reform Act of 1990 or FCRA, credit programs are budgeted for on an accrual basis that records the lifetime cost of the loans disbursed each year.

Specifically, the costs are calculated by discounting to the present the expected cash flows over the life of the loan using maturity-matched, Treasury interest rates as the discount rates.

With interest rates on student loans that are fixed by statute, when market Treasury rates go up, the value of the projected future payments fall and the budgetary cost of the loans increases; and conversely when market rates fall.

Indexing interest rates on student loans would largely eliminate that source of budget volatility.

The move to accrual accounting for federal credit with FCRA represented a significant improvement over the cash accounting that preceded it in terms of accuracy and transparency. However, the requirements use Treasury rates for discounting fail to account for the full cost to taxpayers.

A proposal that would alleviate the understatement of cost in the budget and increase transparency would be to replace FCRA subsidy costs with so-called fair or market value estimates in the budget.

That change would eliminate the artificial appearance that the student loan programs are highly profitable for the government, which is the case now. It would also put credit and noncredit assistance on a more level playing field in the budgetary process.

In particular, it would reduce the cost disadvantage of Pell grants compared to student loans by accurately portraying the cost of the loans.

I also have some comments in my written testimony on the effects of moving to a more income-based repayment system, but in the interest of time, I will end here and look forward to your questions. Thank you.

[The statement of Ms. Lucas follows:]

Prepared Statement of Deborah Lucas, Sloan Distinguished Professor of Finance, Massachusetts Insititute of Technology

Thank you, Chairman Kline and Congressman Miller. To all the members of the committee, I appreciate the opportunity to testify on opportunities to strengthen the Federal student loan programs. My focus will be on four programmatic changes that

are seemingly technical in nature, but which are likely to yield significant benefits to students and taxpayers, and that could increase the stability and transparency of budgetary costs.

Market-Indexed Student Loan Rates

A critical issue is to revisit the rule for how the interest rates on student loans are determined. Student loan interest rates are set in statute. The statutory rules have been changed numerous times throughout the history of the programs, including shifting between fixed interest rates and variable interest rate formulas. Since 2006, new Stafford loans have carried a fixed interest rate of 6.8%. The rate on subsidized loans is fixed at 3.4%, but that rate is scheduled to increase to 6.8% for loans made on or after July 1, 2013. The rates on other types of loans also are fixed in legislation.

The current practice of setting fixed interest rates that extend many years into the future—rather than linking them by formula to prevailing market interest rate conditions—has adverse consequences for students, for taxpayers, and for the stability and control of budgetary costs.

- For students, the current policy creates large swings in the value of government assistance from year to year. Similar students that attend the same school but in different years receive very different amounts of support: Subsidies will be small when market interest rates are low and large when rates are high. As well as raising fairness concerns, the volatility makes it more difficult for prospective students to assess the affordability of pursuing a higher education.
- At the same time, the variability in year-to-year subsidies creates potentially large and uncertain liabilities for taxpayers.
- From a budgeting and control perspective, the uncertain size and volatility of subsidies over time is detrimental to budgetary planning, and it has the effect of reducing the control that Congress exercises over the allocation of scarce budgetary resources.

The volatility in federal subsidies caused by fixing the interest rates on student loans is illustrated in Table 1, which shows the subsidy rates estimated by OMB for loans originated between 2006 and 2011. The pattern of sharply lower subsidies starting in 2009 reflects that the rates charged to students remained constant even as Treasury interest rates fell to historically low levels.

Table 1:

Subsidy Costs for Federal Direct Student Loans

Fiscal Year	Subsidy Rate
2006	5.12
2007	1.48
2008	-0.80
2009	-14.96
2010	-7.66
2011	-13.91

The subsidy rate is the percentage cost of a loan per dollar of principal. For example, a subsidy rate of -10 means that the reported budget deficit was reduced by 10 cents per dollar of loans disbursed.

Source: Federal Credit Supplement 2013

Adopting the alternative of market-indexed rates would reduce the volatility of subsidies for borrowers and taxpayers, and also help to stabilize the budgetary costs of the programs. Under that approach, the interest rate charged on new loans each year would be linked to a market rate, for instance, to a Treasury security with a similar duration to the student loans. The interest rates could still be fixed over the life of each individual loan, but that fixed rate would change year to year.

The notion that allowing interest rates to vary with market conditions would create greater stability and fairness than fixing interest rates by statute may at first

seem unintuitive. However, market-linked interest rates can be beneficial because they result in more stable real (or inflation-adjusted) loan payments. High nominal interest rates generally coincide with periods of high expected inflation rates. Market rates increase with inflation because investors need more compensation just to maintain the purchasing power of the loan repayments they receive. Wages also grow more quickly during periods of higher inflation, making higher nominal payments more affordable to borrowers. Furthermore, low nominal interest rates tend to be a symptom of a weak economy and job market, as is the situation today. Fixing the interest rate by law tends to shrink government subsidies at just those times when students would benefit from them most.

With market-indexed interest rates, the generosity of subsidies could be controlled by choosing an appropriate "interest rate spread"—a number which could be specified in legislation in place of a fixed interest rate. For example, Stafford borrowers could be charged a 3 percent spread over the 10-year Treasury bond rate (which would translate to an interest rate of 5 percent under current interest rate conditions of 10-year rates at about 2 percent). Lower rate spreads could be specified for subsidized loans.

If rates are indexed, policymakers may want to protect borrowers from unusually high interest rate conditions by setting an interest rate cap that limits the maximum rate charged. For example, the cap on consolidation loans is currently 8.25%. However, the lower is the cap that is chosen, the higher the cost and volatility that would be reintroduced. It is worth noting that even without a cap, borrowers would have some protection against unusually high interest rates because student loans can be prepaid without penalty.

Fair Value Accounting for Costs

Because of the way student loans are budgeted for, indexing student loan interest rates would have the effect of lowering the volatility of their budgetary costs over time. Specifically, under the Federal Credit Reform Act of 1990 (or FCRA), credit programs are budgeted for on an accrual basis that records the lifetime cost of the loans disbursed each year. Specifically, costs are calculated by discounting to the present the expected cash flows over the life of the loan using current, maturity-matched, Treasury interest rates as the discount factors.

With interest rates on student loans that are fixed by statute, when Treasury rates go up the value of projected future payments fall and the budgetary cost of the loans increases; and conversely when market rates fall. Indexing the interest rates on student loans would largely eliminate that source of volatility. (Subsidies would still vary over time with changes in projected default rates, program participation, and other factors.)

The move to accrual accounting for federal credit represented a significant improvement over the cash accounting that preceded it in terms of accuracy and transparency. The use of Treasury rates as discount factors, however, fails to account for the full costs of the risks associated with government credit assistance. Those costs must ultimately be borne by taxpayers, just as they must be borne by the equity holders (owners) of private lenders that make private loans.

A consequence of that incomplete accounting for risk is that in recent years student loans have appeared to be quite profitable for the government. For example, OMB reported that the government earned 14 cents per dollar on student loans made in 2011, even though the rates charged were significantly lower than those offered by private lenders, and despite the heightened risk of defaults caused by the still weak job market.

A policy change that could alleviate the understatement of costs in the budget and increase transparency would be to replace FCRA subsidy costs with so-called "fair" or market-based cost estimates in the budget. That change would eliminate the artificial appearance that the student loan programs are highly profitable for the government. To illustrate, Table 2 reproduces CBO's 2010 estimates of the hypothetical effect of switching from FCRA to fair-value estimates of program cost.

Table 2:

Projected Fair-Value and FCRA Subsidy Rates for Representative Loans and Borrowers, by Fiscal Year

(Percent)

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Average, 2010–2020
Fair-Value Estimates (Using risk-adjusted discount rates and including administrative costs)												
Direct Loan Program	13	13	11	7	9	11	12	13	13	13	13	12
FCRA Estimates[a] (Using Treasury discount rates and excluding administrative costs)												
Direct Loan Program	-18	-14	-13	-12	-10	-7	-6	-4	-4	-4	-4	-9

Source: Congressional Budget Office, "Costs and Policy Options for Federal Student Loan Programs," March 2010.

As well as improving transparency about program costs, moving to fair value estimates would have the salutary effect of putting credit and non-credit assistance to students on a more level playing field in the budgetary process. In particular, the budgetary disadvantage of offering Pell grants as compared to student loans would be reduced by using a more comprehensive approach to estimating of the cost of credit assistance.

Income-Based Repayments

Proposals have been put forward to move to a more income-based repayment system, under which borrowers' payments would depend on their earnings after they graduate. Such policies would benefit students in several ways: It would help them avoid unmanageable debt levels, and it would make it easier to pursue careers in lower paying fields such as the military, public service, or teaching. It could be especially beneficial to low-income students whose prospects after graduation are less predictable and who are therefore more wary of taking on debt.

The costs and risks to the government of an income-based repayment scheme would depend critically on the details of how the policy is structured. In principle it would be possible to set up the system in a way that did not increase overall program costs. However, because the savings that would be anticipated from lower default rates are unlikely to fully make up for the higher costs associated with reducing or extending the payments of students who get relief but would not have defaulted under the old system, overall costs would tend to be higher unless the average interest rates charged were also increased.

Restructure the Consolidation Option

Finally, modifying the consolidation option to eliminate borrowers' ability to convert a floating rate loan to a fixed rate loan with the same interest rate could potentially save the government a significant amount of money in the event that Congress ever decides to return to fully floating interest rates. My academic work on the consolidation option suggests that between 1998 and 2005, a period when student loans carried a variable interest rate tied to 3-month Treasury rates, the cumulative cost of consolidation to the government was about $27 billion.[1] The greatest benefits accrue to cohorts who happen to graduate when interest rate conditions are favorable to consolidation, to professional students with the largest loan balances, and to borrowers with the sophistication to manage their loans efficiently. As such, the option is unlikely to be an efficient way to subsidize higher education. The benefits of allowing students to combine all their loans into a single loan could be preserved, but the costs of consolidation reduced, by charging a rate on floating-to-fixed conversions that is linked to a current long-term Treasury rate.

Chairman KLINE. Thank you.

Mr. Delisle, you are recognized for 5 minutes.

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[1] Deborah Lucas and Damien Moore, "The Student Loan Consolidation Option," manuscript, MIT, January 2013.

STATEMENT OF JASON DELISLE, DIRECTOR OF THE FEDERAL EDUCATION BUDGET PROJECT, THE NEW AMERICA FOUNDATION

Mr. DELISLE. Thank you Chairman Kline, Ranking Member Miller, and committee members. Thank you for inviting me to testify about the need to improve the federal student loan program.

If there is one thing recent debates about federal student loans have demonstrated is that Congress needs to develop a rational, long-term plan for setting interest rates.

Currently, the program charges borrowers the same fixed interest rates no matter what happens to other interest rates in the economy, and the rates are arbitrary.

Congress wrote them into law back in 2002, and with the exception of an arbitrary cut to 3.4 percent on some loans, those rates have been in law ever since.

There are a lot of problems with picking a fixed rate that looks about right for the time being and then deciding to cut it in half on some loans some of the time when market or political conditions might warrant it. That approach, as you are all aware, makes rate adjustments in either direction very difficult to legislate.

An upward adjustment is politically unpopular and a downward adjustment is prohibitively costly to taxpayers.

Here is what I believe is a better approach. Set a fixed interest rate for newly issued student loans based on the rate on the 10-year treasury notes time the loans are issued plus three percentage points.

That formula would set rates low enough to provide a subsidy to borrowers. That is, the terms will be better than those in the market all the time, but the rates will be high enough to partially offset the cost of the program. Rates would still be fixed and borrowers would receive lower rates when rates are low and higher rates when rates are high.

On loans issued this coming school year under this approach would carry a fixed rate of 4.9 percent, lower than the current 6.8 percent rate on the most widely available federal student loans. What is more, the rate would be available to all undergraduate and graduate students, unlike an extension of the 3.4 percent rate.

Now of course, under this formula, the rate on loans issued in subsequent years could be higher or lower than today's rates. The Congressional Budget Office projects that long-term interest rates will eventually rise, but this is also why the budget office shows that the proposal I have recommended does not score as a cost over a 10-year window; although there would be costs in the first 5.

Now student aid advocates in some policymakers worry that a rate-setting formula like the one I have recommended could make loans unaffordable for borrowers should interest rates increase significantly.

They suggest capping the rate, yet a cap would be costly for taxpayers and it would reintroduce an arbitrary interest rate back into the program. More importantly, a cap would be redundant. The federal student loan program already includes a built in interest rate cap and it is targeted only to borrowers who need it. It is called income-based repayment, or Pay-As-You-Earn.

Under these programs, borrowers make monthly payments based on their incomes, not the interest rates on their loans. Moreover, the loan terms are fixed at 10 or 20 years through loan forgiveness so that a borrower with a high interest loan would have his debt forgiven before the rate influences payments provided he qualified for the assistance based on his income.

An IBR is an even more effective interest rate cap thanks to the large new benefits that the Obama administration has added to the program.

Now I should note that my colleague, Alex Holt, and I have identified some significant flaws in those new benefits. Our ongoing analysis shows that that graduate and professional students face a clear and obvious incentive to borrow more rather than less.

These students can easily accumulate loan balances where they will bear no incremental cost in borrowing an additional dollar. The added debt and interest will be forgiven under IBR.

So using a very plausible income scenario, we find that once a borrower takes on about $65,000 in debt, he bears none of the incremental costs of borrowing an additional dollar under the new IBR even if he goes on to earn over $100,000 for most of his repayment term.

If he expects to pursue a career in the nonprofit sector, he bears none of the incremental cost of borrowing an additional dollar once he reaches $49,000 in debt.

In other words, the message that this program sends to graduate students is keep borrowing. The message it sends to schools is expand your graduate programs, start new ones, and charge more. These are very bad messages to send.

Fortunately, Congress and the administration can address this problem without rolling back all of the new benefits that IBR and Pay-As-You-Earn provide and I have included those recommendations in my written testimony.

So to wrap up today, I want to reiterate that Congress should set student loan interest rates based on a formula like the one I outlined and let a modified, income-based repayment program cap the interest rate for borrowers who truly need the assistance, but remember to address the perverse incentives and unnecessary benefits that IBR now provides to graduate and professional students.

Thank you. I look forward to answering any questions that you may have.

[The statement of Mr. Delisle follows:]

Prepared Statement of Jason Delisle, Director, Federal Education Budget Project, New America Foundation

Chairman Kline, Ranking Member Miller, and committee members, thank you for inviting me to testify about the need to improve the federal student loan program.

My colleagues in the New America Foundation's Education Policy Program and I have developed a set of recommendations that we believe will improve the federal student loan programs to the benefit of students and taxpayers. These recommendations were first published in two New America Foundation papers, Safety Net or Windfall? Examining Changes to Income-Based Repayment for Federal Student Loans (October 2012) and Rebalancing Resources and Incentives in Federal Student Aid (January 2013). Those recommendations are discussed briefly below.

At the end of this testimony is a brief explanation of the series of events that led Congress to enact the current interest rate structure on federal student loans. That information may be helpful to the Committee as it considers changes to student loan interest rates.

The Case for Reforming Federal Student Loans

• The federal student loan program is extremely complex, offering students and their families a variety of choices, with each carrying different congressionally set interest rates and borrowing limits. Borrowers also face a baffling array of repayment options. Benefits often overlap, which lead to unintended interactive effects.

• Graduate students and the parents of undergraduates can take out loans up to the full cost of attendance. This encourages and enables imprudent borrowing, and also makes it easier for colleges and universities to raise their prices with impunity.

• The benefits of the loan program are poorly targeted. The programs provide generous federal subsidies to some students based on their incomes before they enroll in school, rather than after they graduate, which is when they actually pay their loans back. Students are also charged the same interest rates regardless of changes in market interest rates, such that students are provided different levels of subsidies from year to year for no particular reason. Recent changes to the Income-Based Repayment plan provide the largest benefits to those who borrow most, particularly graduate students, even if they earn a high income.

• The program does not provide enough incentives for students to make steady progress and complete a credential on time. In some cases, it does the opposite.

Recommended Reforms

Address Flaws in the IBR Program and Make it the Sole Repayment Option for Borrowers

A simpler federal loan program with better targeted benefits should offer a single repayment plan that is similar to both the Pay-As-You-Earn plan that the U.S. Department of Education recently enacted (which itself is meant to mimic a plan in statute set to take effect in 2014 and is referenced throughout this testimony as "new IBR") and the Income-Based Repayment plan that was enacted in 2007 (referenced throughout this testimony as "old IBR").[1] This sole repayment plan must incorporate changes to the current system to ensure that it does not provide windfall benefits to higher income borrowers who have the means to repay their debt or indemnify high tuitions and over-borrowing. Those recommended changes are the following:

• Recommendation #1: Maintain the lower payment calculation (10 percent of AGI) in New IBR, but only for borrowers with AGIs at or below 300 percent of the federal poverty guidelines ($33,510 for a household size of one). Borrowers with AGIs above 300 percent will pay according to the Old IBR formula (15 percent of AGI).

Justification: This change targets the benefits of lower monthly payments under New IBR to lower-income borrowers only. Borrowers earning more, while still eligible for IBR, must make payments based on the Old IBR formula. Additionally, by requiring borrowers with incomes above 300 percent of the federal poverty guidelines to make monthly payments based on 15 percent of their AGIs, it is much less likely that high-income borrowers will receive loan forgiveness. It also allows borrowers with lower incomes to benefit from the 10 percent rate that New IBR offers, but ensures that they will repay those benefits by paying at a higher rate if their incomes increase later.

Lastly, those borrowers with AGIs above 300 percent of the poverty guidelines will likely have total incomes that are markedly higher than their AGIs because they are able to make pre-tax benefit payments, contribute to retirement savings, and take larger above-the-line deductions. Imposing a higher payment calculation (15 percent of AGI) on these borrowers compensates for their significantly lower AGIs relative to their total salaries.

• Recommendation #2: Maintain the loan forgiveness threshold from New IBR (20 years), but only for borrowers whose loan balances when they entered repayment do not exceed $40,000. Borrowers with higher initial balances would qualify for loan forgiveness after 25 years of repayment, the same as under Old IBR.

Justification: Like the first recommendation, this proposal would maintain the more generous benefits of New IBR, but not for all borrowers. A two-tiered loan forgiveness system based on initial debt levels would keep the 20-year loan forgiveness targeted toward borrowers who have debt from undergraduate studies or moderate amounts of debt from graduate studies and who struggle to repay. By creating a longer loan forgiveness threshold for borrowers with debt levels above $40,000, this recommendation also reduces the tendency that New IBR has to provide loan forgiveness to high-income, high-debt borrowers when they are most able to make higher payments on their loans for a total of 25 years. This two-tiered approach would discourage graduate and professional schools that charge high tuitions and their students who borrow federal loans from using IBR as an indemnification tool.

• Recommendation #3: Eliminate the maximum payment cap. Borrowers must always pay based on the IBR income formulas, no matter how high their incomes are. Additionally, borrowers may not opt to enroll in another repayment plan.[2]

Justification: The maximum payment cap targets IBR benefits to higher-income borrowers either by reducing their monthly payments, increasing the amount of loan forgiveness they receive, or both. It can also increase the chances that a borrower earning a very high income (over $200,000) would qualify for loan forgiveness. Lastly, requiring that borrowers stay in IBR for the duration of their repayment term will ensure that borrowers who benefited from IBR when their incomes were low will pay commensurately higher payments should their incomes increase—this helps offset some of the initial costs the government incurred when the borrowers benefitted from low payments while their incomes were lower.

• Recommendation #4: The U.S. Department of Education and policymakers should be forthcoming about the negative consequences borrowers may face when repaying through IBR. The Department should provide borrowers with illustrative examples of how paying off their loans more slowly could increase what they pay and provide clear warnings. Private companies servicing federal student loans should clearly indicate to borrowers how much interest accrues on their loans when they repay through IBR and how that is likely to increase the repayment term and total interest costs they will pay.

Justification: IBR entails some financial risks for borrowers (those risks exist for Old IBR, though New IBR entails far less financial risk for borrowers with debt levels that exceed $20,000). Borrowers may save little per month under IBR and end up paying more and for longer due to the added interest costs. Borrowers do make a trade-off in paying a minimum monthly payment under IBR over electing to make pre-payments, and loan servicers and the U.S. Department of Education should ensure that borrowers are informed of those trade-offs.

• Recommendation #5: IBR payments for a borrower who is married but files a separate income tax return should be based on the household's combined AGI. The program currently allows borrowers to file separate income tax returns and use only the borrower's income to calculate payments under IBR. This policy should include an exception for cases where both spouses are making payments on federal student loans under IBR. In that case, each borrower's loan payments should be based on one-half of household income.

Justification: Married borrowers with low individual, but high household incomes can still qualify for IBR (including loan forgiveness) by filing a separate income tax return. If these borrowers also have children, they can significantly increase the benefits they earn under IBR by designating the children as dependents on their annual IBR application since it increases their household size and the poverty exemption they receive under IBR. This provision is another way in which higher-income borrowers (based on household income) can qualify for generous benefits under IBR. Ending this provision will ensure that the program's benefits are targeted to borrowers who need the most assistance. The exception for couples in which each spouse is repaying a federal student loan will ensure that borrowers in a two-borrower household do not each have to make payments on their loans on their combined incomes—which would essentially be double-counting their incomes.

• Recommendation #6: Make loan forgiveness tax-free using budgetary savings that arise from the other recommendations outlined above.

Justification: Federal tax law treats loan forgiveness under IBR (except when provided for public service employees) as taxable income. Borrowers who receive loan forgiveness (under an IBR that reflects the recommendations outlined here) will likely have experienced some degree of financial hardship. Therefore, they are also likely to struggle with what could be a relatively large tax bill in the year they receive loan forgiveness. If IBR is meant to aid this type of borrower, then it should not impose its own type of financial burden on them.

• Recommendation #7: Allow all current borrowers to enroll in an IBR that reflects these recommendations. Do not limit it to new borrowers and new loans.

Justification: Old IBR is available to all borrowers, but Congress and the Obama administration have limited access to New IBR to more recent borrowers to reduce the cost of the program. The recommendations outlined above would preserve some of the benefits of New IBR, but target them to those borrowers with more financial need, thereby reducing the cost. The recommendations would further reduce costs by limiting benefits to higher-income borrowers compared to even Old IBR. Therefore, policymakers could open the program to all borrowers at little or no incremental cost to taxpayers, and a greater number of borrowers would gain access to lower repayments and earlier loan forgiveness.

• Recommendation #8: Ensure that loan servicers have the requisite income information from borrowers when they begin repaying their loans. Require borrowers to

agree in their promissory notes to allow their loan servicers and the U.S. Department of Education to access necessary information from their most recent federal income tax return.

Justification: The main impediment to making IBR the automatic and only repayment plan for all new borrowers is that borrowers must first submit information to loan servicers before their monthly payment can be calculated and billed. Requiring that borrowers authorize the U.S. Department of Education to access the necessary information from their tax returns upon signing a promissory note for a federal student loan will ensure that the loan servicer can calculate a borrower's payment without the borrower having to first submit information.

Repayment Tables for Two Borrowers Under Different Repayment Plans

The tables below are excerpted from Safety Net or Windfall? Examining Changes to Income-Based Repayment for Federal Student Loans.[3]

Graduate A: Starting Balance: $78,393 at 7.000%

Repayment Year	1	3	5	10	15	20	25	30	Total Payments	Forgiven
Salary ($)	45,000	48,431	65,000	110,000	175,000	197,996	224,015	253,452		
IBR Old ($)										
Monthly payment	297	325	500	720	910	910	-	-	**176,460**	-
Loan Balance	80,122	83,063	84,044	81,513	59,545	20,702	-	-		
IBR New ($)										
Monthly payment	198	217	333	480	910	910	-	-	**124,193**	**65,407**
Loan balance	81,188	86,434	90,746	98,025	91,419	65,407	-	-		
IBR Recommended ($)										
Monthly payment	297	325	500	720	1,570	-	-	-	**164,585**	-
Loan balance	80,122	83,063	84,044	81,513	51,631	-	-	-		
Consolidation ($)										
Monthly payment fixed	522	522	522	522	522	522	522	522	**187,758**	-
Monthly payment graduated	459	474	483	514	558	591	642	741	**203,339**	-

Source: New America Foundation. Note: Loan balance reflects principal and accrued unpaid interest at the end of the repayment year indicated. Borrower has a child in each of years six and 10, included in calculation thereafter. Borrower has $8,000 in Subsidized Stafford loans from undergraduate studies.

Graduate C: Starting Balance: $41,570 at 6.875%

Repayment Year	1	3	5	10	15	20	25	30	Total Payments	Forgiven
Salary ($)	28,000	39,000	41,375	48,000	65,000	80,000	97,332	118,420		
IBR Old ($)										
Monthly payment	106	219	152	185	329	444	480	-	**84,582**	**28,633**
Loan Balance	42,855	44,303	46,442	50,467	51,383	42,157	25,869	-		
IBR New ($)										
Monthly payment	70	146	101	123	219	296	-	-	**37,280**	**60,465**
Loan balance	43,196	45,700	49,031	56,478	61,851	60,465	-	-		
IBR Recommended ($)										
Monthly payment	70	146	101	123	219	296	578	-	**68,615**	**46,916**
Loan balance	43,196	45,700	49,031	56,478	61,851	60,465	46,916	-		
Consolidation ($)										
Monthly payment fixed	291	291	291	291	291	291	291	-	**87,150**	-
Monthly payment graduated	241	252	263	288	328	363	446	-	**95,288**	-

Source: New America Foundation. Note: Loan balance reflects principal and accrued unpaid interest at the end of the repayment year indicated. Borrower has one child in year four who is included in calculation thereafter. Loan balance includes $8,000 in Subsidized Stafford loans from undergraduate studies.

Graduate D: Starting Balance: $165,882 at 7.375%

Repayment Year	1	3	5	10	15	20	25	30	Total Payments	Forgiven
Salary ($)	90,000	93,600	101,238	135,000	164,248	243,360	249,505	255,805		
IBR Old ($)										
Monthly payment	747	774	844	1,248	1,442	1,958	1,958	-	**409,445**	**23,892**
Loan Balance	169,154	175,430	180,061	184,231	164,920	112,129	23,892	-		
IBR New ($)										
Monthly payment	498	516	563	832	961	1,603	-	-	**202,299**	**208,259**
Loan balance	172,141	184,481	195,724	218,894	226,410	208,259	-	-		
IBR Recommended ($)										
Monthly payment	747	774	844	1,248	1,442	2,405	2,309	-	**423,507**	-
Loan balance	169,154	175,430	180,061	184,231	164,920	100,022	-	-		
Consolidation ($)										
Monthly payment fixed	1,146	1,146	1,146	1,146	1,146	1,146	1,146	1,146	**412,454**	-
Monthly payment graduated	1,008	1,042	1,063	1,133	1,232	1,304	1,420	1,647	**448,656**	-

Source: New America Foundation. Note: Loan balance reflects principal and accrued unpaid interest at the end of the repayment year indicated. Borrower has a child in each of years eight and 12, included in calculation thereafter.

Figures for the recommended IBR changes reflect all proposed changes listed in this testimony except that borrower income does not reflect household income. All borrowers file separate federal income tax returns and designate any children that they have as dependents. The interest rate for all repayment plans is the rate the borrower would pay under the consolidation plan, which is the weighted average rate rounded to the nearest one-eighth of one percent.

End the Subsidized Stafford Interest Rate Benefit

Since the passage of the Higher Education Amendments of 1992, all undergraduate borrowers have been able to take out federal Stafford loans regardless of income or other need-based tests, at terms that have been generally more favorable than those in the private market.[4] Prior to the enactment of that policy, the federal loan program allowed only financially needy students to borrow.[5] These loans had always included an interest-free benefit under which the loan would not accrue interest while the borrower was in school. However, when policymakers opened up the federal student loan program to borrowers of all income backgrounds in 1992, they maintained the interest-free benefit for borrowers who met a needs analysis test that accounted for the cost of attendance at students' institutions, but did not provide a similar benefit for other borrowers. That interest-free benefit remains the distinction between the two loan types that still exist in today's program: Subsidized Stafford loans and Unsubsidized Stafford loans.

In other words, Subsidized Stafford loans were not created to provide benefits over and above those on Unsubsidized Stafford loans. Rather, it is a benefit that was always provided as part of the federal student loan program. The Subsidized and Unsubsidized Stafford loan distinction remains current policy mainly due to historical circumstances. That fact is made clearer by some of the policy's shortcomings and how it interacts with the myriad changes policymakers have made to the student loan programs in recent years.

In fact, Subsidized Stafford loans do not always provide the greatest benefits to the lowest-income students. Subsidized Stafford loans are awarded to borrowers in part according to the cost of attendance of their schools. That means a borrower with a high-family income will be eligible for the loans if he attends the most expensive type of institution, while a similarly situated borrower who opts to attend a low-cost institution will qualify only for Unsubsidized Stafford loans. This is why, in spite of income and assets tests targeting the aid to lower income families, 12 percent of borrowers who receive Subsidized Stafford loans come from families earning over $100,000 per year.

Furthermore, the Income-Based Repayment Plan better aligns repayment with a borrower's ability to repay, whereas Subsidized Stafford loans are provided to borrowers based largely on their family income when they enter school. For example, borrowers with Unsubsidized Stafford loans begin repayment with higher loan balances than students with Subsidized Stafford loans (assuming everything else is equal) because interest has accrued on the loan. Under IBR, the higher loan balance does not necessarily mean the borrower will pay more than if he had a lower loan

balance—monthly payments are based on a borrower's income, not loan balance. Therefore a borrower who earns a persistently low income over his repayment term would make the same payments regardless of the size of his initial loan balance. Only borrowers with higher incomes in repayment stand to gain from Subsidized Stafford loans.[6]

The Obama administration recommended in 2011 that graduate students be eliminated from the Subsidized Stafford program going forward, and Congress acted on that policy, redirecting the budgetary resources to the Pell Grant program. The administration noted that, in addition to the Income-Based Repayment option available to graduate and professional students, "eligibility for the interest subsidy is based on 'ability-to-pay' at the time of enrollment, but the borrower realizes the benefit later—typically years later—in the form of lower loan payments after leaving school."[7] The administration also argued that government aid should be targeted to the highest-need students.[8] All of those arguments apply to the case for eliminating the Subsidized Stafford loan interest-free benefit for undergraduate students, particularly if IBR is the only repayment option for borrowers.

Create a Fixed Formula for Setting Student Loan Interest Rates

Interest rates on federal student loans are arbitrary and inflexible because Congress set the rates as nominal figures in law based on what would have been a subsidized interest rate in the year 2001.[9] They are not based on any formula, nor do they bear any relation to changes in related interest rates in the market since then. The rate on all newly-issued Unsubsidized Stafford loans as of 2006 is 6.8 percent, and under current law will remain so in perpetuity.

The effect of such a policy is to provide very different levels of subsidies to borrowers depending on when they take out their loans. The subsidy on loans issued at the 6.8 percent interest rate in 2007 when the economy was booming and interest rates were relatively high was much larger than the subsidy provided to students in today's low-interest rate, slow-growth economy. That means students receive larger subsidies when they are least needed; the policy is both inefficient and unfair. In fact, the Congressional Budget Office estimates that the loans issued in fiscal year 2013 will not provide any subsidies (meaning the terms provide no value over loans in the private market) to the vast majority of borrowers.[10] This will be the first time that federal student loans provide no subsidy, based on fair-value estimates.

A better policy would be to set interest rates on all newly-issued federal student loans at 3.0 percent, plus a markup equal to long-term U.S. Treasury borrowing rates. The fixed rate of 3.0 percent would ensure that the government partially covers the costs of making the loans (i.e. administrative costs and costs associated with defaults, collections, and delinquencies), and the markup would allow the loan rates to adjust based on long-term interest rates. The interest rates charged to borrowers would still be fixed for the life of the loan, but the rate for new loans would change each year based on the market rates for 10-year Treasury notes.

Under that formula, the interest rate for federal loans issued for the 2012-13 school year would be about 4.9 percent, a big drop from the 6.8 percent rate that is currently charged on Unsubsidized Stafford loans. That rate would be available on all newly issued Stafford loans to undergraduate and graduate borrowers.

Because the rate offered on newly-issued loans would adjust annually, it could be higher in future years. However, Income-Based Repayment on federal student loans, coupled with loan forgiveness after 20 or 25 years in repayment, ensures that the rate a borrower pays cannot rise to unaffordable levels regardless of the loan's nominal rate. It also ensures that borrowers earning higher incomes, those who are most able to pay, are the only ones who could face higher interest rates under the policy. Income-Based Repayment is effectively an income-based interest rate cap that provides benefits to borrowers based on need, but it determines the cap in repayment, rather than at the time of enrollment.

How IBR Works as an Interest Rate Cap

The following scenarios were developed using the New America Foundation IBR calculator.[11]

Consider someone with $45,000 in debt from undergraduate and graduate studies who works in the government/non-profit sector and earns a starting salary of $38,000 (AGI of $34,200) with a four percent annual raise. At an interest rate of 4.9 percent, she pays a total of $22,281 on her loans over 10 years, and then the remaining balance is forgiven under Public Service Loan Forgiveness. At an interest rate of 12 percent she still pays $22,281 and the remaining balance is forgiven. Even if her interest rate were 0.0 percent, her total payments would still be $22,281.

What if the same person worked in the for-profit sector and therefore qualifies for loan forgiveness after 20 years of payments instead of 10? At an interest rate of 4.9 percent, her total payments over 20 years are $58,998, and she has some remaining debt forgiven. Increase her interest rate to 12 percent and her total payments are still $58,998. IBR has capped her payments—and the interest rate on her loan—because her income is not high enough for the interest rate to matter.

As another example, consider a borrower with undergraduate debt of $28,000, who works in the for-profit sector, with a starting income of $29,000 (AGI of $26,100) and an annual increase of three percent. She would pay $27,228 on her loans over 20 years at an interest rate of 2 percent, 5 percent, or 25 percent. Her monthly payments over that time would be no higher or lower under any of those interest rates.

Under IBR, only borrowers with higher incomes would be affected by higher interest rates. But the program still provides a cap even for these borrowers, albeit a higher cap. Moreover, monthly payments are still based on income; only the length of payment is affected by the interest rate. And high-income borrowers who work for the government or non-profit organizations fare even better, because they qualify for 10-year loan forgiveness.

Imagine a borrower with $40,000 in debt and a starting salary of $50,000 (AGI $45,000), who receives an annual raise of four percent. If she works for a non-profit employer, the interest rate on her loan is irrelevant. She will pay $35,247 before her remaining debt is forgiven (after 10 years of payments) whether the interest rate is 2 percent, 6 percent or 12 percent. However, if she works for a for-profit employer, her higher income means she will pay for longer if the interest rate is higher. But if the rate is 8 percent or higher, she won't pay all of the extra costs. Instead, she will have much of it forgiven once she reaches 20 years of payments.

Set One Loan Limit for All Undergraduates, Irrespective of Their Dependency Status

Policymakers should simplify the federal loan program by eliminating the distinction between dependent and independent undergraduates and allowing both types of students to borrow the same amount of loans. Under the New America Foundation proposal, the annual limits for all undergraduates would be $6,000 for a first year student, $7,000 for a second-year student, and $9,000 for a third-, fourth-, or fifth-year student. The aggregate limit for undergraduates would be $40,000.

These proposed limits are higher than dependent undergraduates can currently borrow on their own but less than independent undergraduates can take out. This increase is appropriate due to our proposed elimination of Parent PLUS loans, which is outlined later in this document, and the fact that current loan limits for independent students can lead to excessive amounts of debt. As of now, an independent undergraduate student who borrows the maximum in federal loans would begin repayment with a principal and interest balance of approximately $74,000, an amount that would require $486 monthly payments over 30 years to repay under the currently available repayment plans.

End Grad PLUS, but Increase Stafford Loan Limits for Graduate Students

Policymakers should end the Grad PLUS loan program. This program allows graduate and professional students to borrow up to the full cost of attendance at an institution of higher education, with no time or aggregate limit. Such a policy, especially when coupled with loan forgiveness and Income-Based Repayment, can discourage prudent pricing on the part of institutions and prudent borrowing by students. However, policymakers should increase the annual limit on Unsubsidized Stafford loans for graduate students from the current $20,500 to $25,500 to replace some of the borrowing ability graduate students will lose when the Grad PLUS loan program is eliminated.

If institutions can no longer rely on PLUS loans to fund their high-tuition programs and if the private market is responsive to the ability of borrowers to repay, then graduate schools may have to set their pricing based, in part, on students' expected earnings. Since those in graduate school already have an undergraduate degree and are preparing for a profession, it is more reasonable to expect that loans above the Stafford limits be based on prospective ability to repay. Underwriters will likely focus most intently on institutional characteristics to determine risk. Consequently, programs that poorly prepare students to repay their debts will find that their students cannot access much credit in the private market, which should change institutional behavior in terms of quality and pricing.

End Parent PLUS Loans

In addition to ending the Grad PLUS loan program, policymakers should eliminate the Parent PLUS loan program. As the cost of attending college has soared, so too have Parent PLUS loan disbursements. According to a recent article in The

Chronicle of Higher Education, the government issued $10.6 billion of Parent PLUS loans to approximately one million families last year.[12] That is nearly double the numbers of borrowers and an increase of $6.3 billion over the past decade alone. Many colleges use these loans when packaging financial aid to fill large gaps in financial aid awards.

Parents can borrow up to the cost of attendance at the schools their children attend, which means families can easily over-borrow, and institutions have an easy source of funds if they wish to raise tuition. Moreover, the federal government does not track or publish the rate at which parents default on PLUS loans at each institution. Lastly, the loans carry a relatively high fixed interest rate of 7.9 percent and origination fee of four percent, which can pose a financial risk to vulnerable families; and the loans are not eligible for repayment options designed to help struggling borrowers, like Income-Based Repayment.

Limit Loans to 150% of Program Length

The package of student aid reforms presented here proposes both annual and aggregate limits for federal student loans and gives colleges the flexibility to adopt lower limits for their students. We also believe that policymakers should add a new program-length limit that would apply in addition to the annual and aggregate limits. The new limit would end loan eligibility once a borrower exceeds 150 percent of the standard time needed to complete the degree or program that he is pursuing. For instance, a student who borrows $5,000 per year over six years to complete a four-year degree would, under this proposal, exhaust his eligibility for federal student loans, even though he did not exceed the annual or aggregate borrowing limit. This policy is meant to discourage extended and prolonged enrollments beyond 150 percent of the time the student would need to complete his or her program.

The policy would leave in place the annual limit and aggregate limit on borrowing for students who may begin one type of program but switch to another. In other words, the 150 percent time limit would start over when the student enrolls in a new program, but the overall aggregate and annual limits would still apply. Meanwhile, time spent in remedial education would not count toward the 150 percent program-length limit. The proposal would also prorate annual loan limits if a student pursues his or her program on a half-time basis.

History of Federal Student Loan Interest Rates

Why the Federal Student Loan Interest Rate Is 6.8 Percent

Since the 1960s, the federal government has supported a loan program that helps students pay for the cost of higher education at institutions across the country. While the program has undergone many changes and evolved to provide loans to students from all income backgrounds, its original purpose remains. The program ensures that students can borrow at favorable terms without regard to their credit histories, incomes, assets, or fields of study.[13] In 2013, students and parents are expected to borrow $106 billion in federal loans, and over $800 billion in federal student loans were outstanding in 2011.[14]

From the program's inception until 1992, Congress set the interest rate on student loans at fixed rates ranging from 6.0 percent for loans issued in the 1960s to 10.0 percent for loans issued between 1988 and 1992.[15] Congress enacted variable rates in 1992, seeking to better align them with the interest rate the government paid private lenders holding the loans and thereby reduce the government's costs.[16] The new variable rates reset once a year and consist of the interest rate on short-term U.S. Treasury securities plus 3.1 percentage points (a "markup"), capped at 9.0 percent. Congress made minor adjustments to this formula over the subsequent six years, lowering the markup and the cap.

Shortly after the move to variable rates, in 1993 Congress passed the Student Loan Reform Act to establish the Direct Loan program.[17] Congress intended this program, under which the U.S. Department of Education makes loans directly to students, to gradually replace the existing program that subsidized private lenders to make loans (i.e., the bank-based program). At the time, policymakers also sought to more closely link the interest rates borrowers were charged to the rates the government paid to borrow since there would be no further need to link them to subsidies for private lenders.[18] In response, the 1993 law pegged borrower rates to longer-term U.S. Treasury securities that were similar in duration to the student loans, plus a smaller markup of 1.0 percentage point would be calculated for loans issued after July 1, 1998.[19] This formula would also be used to set the interest rate guaranteed to lenders for any loans still made in the bank-based program in 1998 and later.

By the mid-1990s, the Direct Loan program phase-in had not gone as Congress had originally planned; as 1998 approached, the bank-based program still accounted

for the majority of newly issued federal loans. However, the pending interest rate change for both borrowers and lenders enacted in 1993 was still set to occur in 1998. As a result, lenders in the bank-based program—who Congress assumed in 1993 would not be playing the major role they still were in 1998—expressed concerns that the interest rate change would increase their costs and reduce returns to such an extent that they would no longer be willing to make federally backed student loans.[20]

Fearing that lenders would flee the program and disrupt loan availability, in 1998 Congress postponed the pending rate changes until 2003 (a permanent fix was too costly) and left the then-current interest rate formulas in place with some minor adjustments (it reduced the markup on the borrower's annual interest rate from 3.1 to 2.3 percentage points). Despite this action, lenders participating in the bank-based loan program continued to express worries over the interest rate structure change, now delayed until 2003. They encouraged Congress to address it before mid-2002 to avoid disrupting student loan availability.

As an alternative to the pending rate change, lenders and some lawmakers proposed making permanent the then-current formulas (short-term interest rates plus 2.3 percentage points). But student advocates and some lawmakers opposed this approach because the formula set to take effect in 2003 (variable rates based on longer-term U.S. Treasury rates plus 1.0 percentage point) produced more favorable rates for borrowers.[21] At the time, short-term and long-term Treasury rates were similar, meaning that the lower markup built into the pending formula produced lower overall rates.

In late 2001, after months of negotiations, lawmakers proposed a bipartisan compromise that would avert the pending rate change and make permanent the then-current interest rate formula for lenders. It also extended through 2006 the existing variable rate formula for borrowers but established fixed interest rates at 6.8 percent for Subsidized and Unsubsidized Stafford loans made after July 1, 2006.[22]

Lawmakers, higher education associations, and student advocate organizations championed the bill because the fixed 6.8 percent interest rate that would start in 2006 was lower than estimates of what borrowers would pay if Congress had maintained the variable formula.[23] In selecting a fixed rate, Congress and advocacy groups decided on 6.8 percent because it was approximately the average of the projected interest rates set to take effect in 2003 based on longer-term U.S. Treasury bills.[24] Supporters also cited the certainty that fixed rates provided over variable rates as a benefit to borrowers. The Senate passed the bill unanimously in December 2001, the House passed it with overwhelming support in January 2002, and the president signed it into law.

Congress chose to delay the implementation of the fixed rates until 2006—maintaining the existing variable rate formula in the meantime—to reduce the costs of the policy over a ten-year budget window. The Congressional Budget Office estimated that adopting fixed rates would reduce the rates for borrowers compared to then-current law, increasing costs for the government by $5.2 billion from 2007-2011.[25] It would have cost more if Congress had chosen to implement the change immediately.

Meanwhile, in the latter half of 2001, the U.S. Federal Reserve was in the midst of reducing its short-term benchmark interest rate in response to a mild economic recession and the terrorist attacks of September 11th. By the time the ink was dry on the 2002 law that established the fixed 6.8 percent interest rate, the Federal Reserve had cut short-term interest rates below 2.0 percent. It had been as high as 6.5 percent in early 2001. Two more Federal Reserve rate cuts in 2002 and 2003 brought the rate to 1.25 percent and 1.0 percent, respectively. Given the low-interest-rate environment that began in 2002, it appeared unlikely that a fixed 6.8 percent rate would lower costs for borrowers as supporters had previously argued.

A 2005 Effort to Block Fixed Rates Sets Stage for Temporary Rate Cut

Despite the low interest rate environment of the mid-2000s, the fixed rates scheduled to take effect in 2006 received little attention until 2005, when Congress considered proposals to reduce annual budget deficits. That year, Republican majorities in the House and Senate began drafting legislation to cut spending and reduce budget deficits. Both chambers made changes to federal student loans a large component of their respective proposals, spurred by reforms outlined in the president's budget request.

The House plan would have canceled the fixed interest rates set to take effect in 2006, maintaining the existing variable rate formula, which that year set rates between 3.4 and 5.3 percent.[26] Sponsors of the proposal argued that variable rates would be better for borrowers and taxpayers. The Senate, however, maintained the fixed rates set to take effect in 2006.[27]

To meet deficit reduction goals, both the House and Senate bills made a change to the interest rate guaranteed to lenders making federally backed student loans. The bills included a provision that required lenders to rebate interest that borrowers paid in excess of the rate at which the government guaranteed lenders.[28] The provision cut spending compared to then-current law because it reduced what lenders could earn on the loans. However, the Senate bill had a larger deficit-reducing effect because it left the scheduled fixed rates in place, increasing the size of the lender rebates. The rebate provision produced $34.4 billion in savings over ten years in the Senate bill compared to $14.5 billion under the House's variable rate proposal.[29]

Why Interest Rates on Some Loans May Double This Year

The president signed a final version of the deficit reduction bill into law in January 2006, which included the Senate's proposal to maintain the fixed rate formula and impose a rebate on lenders.[30] Even though Congress enacted the fixed rates in 2002, some observers interpreted Congress' decision to maintain the rates as a Republican-led Congress charging higher interest rates on student loans to reduce the deficit.

In their 2006 campaign platform, A New Direction for America, House Democrats claimed that "Congressional Republicans * * * have allowed student loan interest rates to increase, making student loans even harder to repay." The platform document promised to "slash interest rates on college loans in half to 3.4 percent for students and to 4.25 percent for parents," if Democrats were elected that fall.[31]

After Democrats won majority control of both the House and Senate in 2006, the Congressional Budget Office revealed that the proposal was extremely costly, estimating that the rate cut proposal would cost $52 billion and $133 billion over five and ten years, respectively, compared to then-current policy. The rate cut on PLUS loans for graduate students and parents accounted for about two-thirds of the cost.

The high cost of the proposal did not bode well for the Democrats' campaign pledge because the newly elected majority had also pledged to follow Pay-As-You-Go budgeting principles to fully offset new spending with tax increases or other spending cuts. The Pay-As-You-Go principles meant that lawmakers would have to enact $132 billion in spending cuts over ten years (a substantial sum) within education or other programs, or raise taxes to offset the new spending in the rate cut proposal. In the end, lawmakers opted to scale back their original proposal to reduce the cost.

Just weeks into the new session of Congress in January 2007, the new House Democratic majority passed a bill to cut interest rates in half, but with significant caveats.[32] The bill cut rates in half only for a subset of loans—Subsidized Stafford loans—which are available only to borrowers from families with middle and lower incomes. While both graduate and undergraduate students had been eligible for Subsidized Stafford loans, only undergraduate students were eligible for the rate cut. The bill left rates unchanged for the largest loan category—Unsubsidized Stafford loans—as well as for PLUS loans for parents and graduate students, despite their inclusion in the campaign pledge. All new costs in the bill were offset with spending reductions on subsidies for lenders making federally-backed student loans, ensuring that the bill complied with Pay-As-You-Go principles.

To further reduce the cost of the proposal, the bill phased in incremental rate cuts starting in the 2008-09 school year such that only loans issued for the 2011-12 school year would carry rates of 3.4 percent (half of 6.8 percent). Subsidized Stafford loans issued after that year would again carry a fixed rate of 6.8 percent. In short, the proposed legislation "cut interest rates in half" for loans issued only in one year.

The changes to the original proposal—limiting the cut to Subsidized Stafford loans for undergraduates, phasing it in, and ending it in 2012—reduced the cost to $7.1 billion in the ten-year budget window, much less than the earlier estimate for the permanent cut for all loan categories. Making the rate cut permanent for Subsidized Stafford loans for undergraduates after 2012 would have cost an additional $12.8 billion over ten years.[33]

In September of 2007, both the House and Senate passed a budget bill that included the rate cut provision, and the president signed it into law.[34] The first rate cut went into effect for Subsidized Stafford loans issued in the 2008-09 school year.

Loans issued for the 2012-13 school year were originally set to carry a 6.8 percent interest rate, because the 2007 rate cuts would have expired. However, in 2012, President Obama included in his fiscal year 2013 budget request to Congress a proposal to extend the rate cut under the 2007 law for one additional year.[35] Later that year, Congress passed and the president signed into law a one-year extension of the 3.4 percent interest for Subsidized Stafford loans issued to undergraduates during the 2012-13 school year.[36] The extension was included on a broader piece of legisla-

tion that included provisions that the Congressional Budget Office estimated would offset the $6 billion cost of the extension.[37] One of those provisions was a limitation on a separate interest rate benefit available on Subsidized Stafford loans that the president had also included in his fiscal year 2013 budget request.

As it stands today under current law, all-newly issued Subsidized Stafford loans will be issued with a fixed interest rate of 6.8 percent on July 1st, 2013 and thereafter.

ENDNOTES

[1] PAYE: 77 Fed Reg. 66087, (November 1, 2012): *http://www.gpo.gov/fdsys/pkg/FR-2012-11-01/pdf/2012-26348.pdf.* 2014 law: P.L. 111-152 B2213. 2007 Law: College Cost Reduction and Access Act, Public Law 110-84 B203(c)(1), 110th Congress (September 27, 2007), Available: U.S. Government Printing Office, *http://www.gpo.gov/fdsys/pkg/PLAW-110publ84/pdf/PLAW-110publ84.pdf.* The 2007 law set the effective date on and after which borrowers could enroll at July 1, 2009.

[2] The recommended IBR would capitalize a borrower's accrued unpaid interest once his payments under IBR exceed what he would be required to pay under the standard 10-year repayment plan based on his original loan balance. This is consistent with the practice currently under both Old and New IBR.

[3] Jason Delisle and Alex Holt, "Safety Net or Windfall? Examining Changes to Income-Based Repayment for Federal Student Loans," New America Foundation (October 2012) *http://newamerica.net/publications/policy/safety—net—or—windfall*

[4] P.L. 102-325.

[5] Cervantes, Angelica, Marlena Creusere, Robin McMillion, Carla McQueen, Matt Short, Matt Steiner, Jeff Webster, "Opening the Doors to Higher Education: Perspectives on the Higher Education Act 40 Years Later," TG Research and Analytical Services (November 2005): *http://www.tgslc.org/pdf/hea—history.pdf.*

[6] Delisle, Jason and Alex Holt, "Subsidized Stafford Loans Obsolete and Regressive Due to New Income Based Repayment," Ed Money Watch (November 15, 2012): *http://edmoney.newamerica.net/blogposts/2012/subsidized—stafford—loans—obsolete—and—regressive—due—to—new—income—based—repayment-7.*

[7] "FY 2012 Justifications of Appropriations Estimates to Congress: Student Loans Overview," U.S. Department of Education," (March 31, 2011): *http://www2.ed.gov/about/overview/budget/budget12/justifications/s-loansoverview.pdf,* S-15.

[8] Ibid.

[9] Delisle, Jason, "Federal Student Loan Interest Rates: History, Subsidies, and Cost," Federal Education Budget Project (February 2012): *http://edmoney.newamerica.net/sites/newamerica.net/files/policydocs/Interest%20Rates%20Issue%20Brief%20Final—0.pdf.*

[10] "Fair-Value Estimates of the Cost of Federal Credit Programs in 2013," Congressional Budget Office (June 2012): *http://www.cbo.gov/sites/default/files/cbofiles/attachments/06-28-FairValue.pdf.*

[11] Delisle, Jason and Alex Holt, "New America Releases Income-Based Repayment Calculator for Forthcoming Report," Ed Money Watch (October 10, 2012): *http://edmoney.newamerica.net/blogposts/2012/new—america—releases—income—based—repayment—calculator—for—forthcoming—report-72603.*

[12] Wang, Marian, Beckie Supiano, and Andrea Fuller, "The Parent Loan Trap," The Chronicle of Higher Education (October 4, 2012): *http://chronicle.com/article/The-Parent-Plus-Trap/134844.*

[13] White House Office of Management and Budget. Analytical Perspectives: FY2012 Budget, Page 369. *http://www.whitehouse. gov/sites/ default/files/omb/budget/ fy2012/assets/topics.pdf.*

[14] White House Office of Management and Budget. Analytical Perspectives: FY2013 Budget. *http://www.whitehouse.gov/sites/default/files/omb/budget/fy2013/assets/topics.pdf;* Congressional Budget Office. CBO February 2013 Baseline Projections for the Student Loan Program. *http://www.cbo.gov/sites/default/files/cbofiles/attachments/43913—StudentLoans.pdf.*

[15] Senate Budget Committee. "2002 Student Loan Law Takes Effect, Lowers Interest Rates." Budget Bulletin, August 4, 2006.

[16] Until the early 1990s when Congress created the Direct Loan program, private lenders made and held all federal student loans. The government guaranteed the loans against default losses and guaranteed lenders a minimum interest rate each financial quarter that was based on short-term U.S. Treasury securities (plus a markup) if the rate the borrower paid fell below this formula in any given financial quarter. Congress terminated the guaranteed loan program in 2010 and no new loans have been through the program since July of that year.

[17] Omnibus Budget Reconciliation Act of 1993, P.L. 103-66, Title IV.

[18] U.S. Department of Education. "The Financial Viability of the Government-Guaranteed Student Loan Program," Page 2, February 1998. *http://www2.ed.gov/PDFDocs/stuloan9.pdf.*

[19] Policymakers may also have chosen the new formula because longer-term interest rates are less volatile than the short-term rates used to set student loan rates at the time.

[20] U.S. Department of Education. "The Financial Viability of the Government-Guaranteed Student Loan Program," Page 2, February 1998. *http://www2.ed.gov/PDFDocs/stuloan9.pdf;* Burd, Stephen. "Bill Provides Fix for Dispute Over Interest Rates on Student Loans," Chronicle of Higher Education, June 5, 1998.

[21] Stoll, Adam. "Memorandum: Student Loans: Replacing the Interest Rate Structure Scheduled to Take Effect in 2003," Congressional Research Service, June 14, 2001.

[22] The law also set a fixed rate of 7.9 percent for PLUS loans made to parents of undergraduates. P.L. 107-139. *http://www.gpo.gov/fdsys/pkg/PLAW-107publ139/pdf/PLAW-107publ139.pdf.*

[23] Bannon, Ellynne. "Student Loan Interest Rate Legislation (S. 1762) Will Make College More Affordable for Millions." The State PIRGs' Higher Education Project, January 24, 2002. *http://www.pirg.org/highered/media/1—24—02.html.*

[24] Burd, Stephen. "Lenders and Student Advocates Seek a Deal on Interest Rates." Chronicle of Higher Education, October 12, 2001.

[25] 25 Congressional Budget Office. "Pay-As-You-Go Estimate: S. 1762," January 30, 2002. *http://www.cbo.gov/ftpdocs /32xx/doc3282/s1762.pdf.*

[26] U.S. Congress. House. College Access and Opportunity Act of 2006, H.R. 609. February 8, 2005. *http://www.gpo. gov/fdsys/pkg/BILLS-109hr609eh/pdf/BILLS-109hr609eh.pdf.*

[27] The law also increased the interest rate charged on Parent PLUS loans made under the bank-based program and created a new category of loans that allowed graduate students to borrower Parent PLUS loans for themselves up to the full cost of attendance.

[28] This would have ended an existing policy that allowed lenders to keep the excess interest—sometimes called "floor income" or "windfall profits."

[29] Congressional Budget Office. "Cost Estimate: S. 1932," January 27, 2006. *http://www.cbo.gov/ftpdocs/70xx/doc7028/s1932conf.pdf;* Congressional Budget Office. "Cost Estimate: H.R. 609," September 16, 2005. *http://www.cbo.gov/ftpdocs/66xx/doc6648/hr609.pdf.* The Senate proposal also increased the fixed rates on PLUS loans for parents and graduates students to 8.5 percent from 7.9 percent for loans issued under the bank-based loan program and was included in the final law. This change also increased the deficit reduction compared to the House proposal.

[30] Deficit Reduction Act of 2005. P.L. 109-171. *http://www.gpo.gov/fdsys/pkg/PLAW-109publ171/pdf/PLAW-109publ171.pdf.*

[31] "A New Direction for America," Office of House Democratic Leader Nancy Pelosi. *http://www.democraticleader.gov/pdf/thebook.pdf.*

[32] "Estimated Impact on Direct Spending of H.R. 2669 with Possible Extensions." Congressional Budget Office, July 10, 2007. *http://www.cbo.gov/ftpdocs/83xx/doc8303/hr2669Ryanltr.pdf.*

[33] While lawmakers needed to offset all the new spending provisions in the bill with spending reductions to comply with Pay-As-You-Go principles, they also needed to meet a similar requirement to pass the bill under budget reconciliation procedures which require that new spending in a bill be budget-neutral in the latter-years of a budget window. Legislation passed using budget reconciliation procedures cannot be filibustered in the Senate and therefore needs only a simple majority to pass.

[34] College Cost Reduction and Access Act. P.L. 110-84. *http://www.gpo.gov/fdsys/pkg/PLAW-110publ84/pdf/PLAW-110publ84.pdf.*

[35] White House Office of Management and Budget. FY2013 Budget, Page 97. *http://www.whitehouse.gov/sites/default/files/omb/budget/fy2013/assets/budget.pdf.*

[36] Moving Ahead for Progress in the 21st Century Act. P.L. 112-557. *http://www.gpo.gov/fdsys/pkg/PLAW-112publ141/pdf/PLAW-112publ141.pdf.*

[37] Congressional Budget Office. "Cost Estimate: H.R. 4348, MAP-21," June 29, 2012. *http://www.cbo.gov/publication/43368.*

Chairman KLINE. Thank you.

Mr. Draeger, you are recognized.

STATEMENT OF JUSTIN DRAEGER, PRESIDENT AND CEO, NATIONAL ASSOCIATION OF STUDENT FINANCIAL AID ADMINISTRATORS

Mr. DRAEGER. Thank you, Chairman Kline, Ranking Member Miller, and members of the committee for this invitation to testify.

The National Association of Student Financial Aid Administrators represents 3,000 colleges and universities from across the nation. Collectively, our financial aid administrators serve 97 percent of all federal student aid recipients and today I would like to share some of the practical implications of our current student loan policies that aren't working for students.

Today, it is estimated that nearly 40 million Americans have outstanding student loan debt and at current projections, the number of people with federal student loans will soon exceed the number of people receiving Social Security or food stamps.

In other words, federal student loans could soon be the United States' largest federal assistance program. That puts added pressure on us to make sure that we get these policies right and keep

federal loans accessible, affordable, predictable, and fiscally sustainable.

The current structure of federal student loan interest rates is out of step with current market rates and is confusing for students and parents. The current interest rate on federal unsubsidized Stafford loans is near 7 percent. The current interest rate on federal PLUS loans for graduate students and parents is nearly 8 percent, and this is after a 4 percent off the top origination fee.

These rates make it nearly impossible for financial aid administrators to stress the benefits and safeguards of the federal loan programs compared to private loans. The federal loan programs help students avoid default through safeguards such as deferment, forbearance, loan forgiveness, income-based repayment, and discharge for disability and death. All of this is overshadowed when private market loans are currently offered at much lower rates.

Yes, the interest rate on subsidized Stafford loans is currently at 3.4 percent, much closer to market rates, but the subsidized Stafford loan program only serves a fraction of all federal loan borrowers and half of them, half of the subsidized Stafford loan borrowers, are also borrowing unsubsidized Stafford loans at double the rate.

If financial aid weren't confusing enough, we have created a situation essentially where 4 million students have one loan with two different interest rates.

We recognize that to you as lawmakers must find the right balance between benefits to students and risk to taxpayers for the source of this funding.

Within that effort, NASFAA is advocating for a long-term, market-based solution by returning to a variable interest rate that is determined based on cost of government capital and origination, cost of proper loan servicing, and future market risk.

Moving to a rate based on the market with cost built in ensures students and parents have access to safe loans at a competitive rate all while creating stability in the loan programs.

Federal student loans could further be strengthened through some additional policy changes unrelated to interest rates and this is the second area I would like to address today.

First, institutions need more flexibility in providing counseling and limiting borrowing to ensure students are academically prepared, understand their loan obligations, and are able to keep loan borrowing in check.

Currently, federal student loans are considered entitlement aid and schools are not permitted in any practical way to limit part-time students from borrowing at full-time rates or to deter students enrolled in 2-year programs from borrowing up to 4-year levels.

Schools aren't even able to require additional loan counseling over and above minimal federal requirements for students enrolled in programs that statistically produce a disproportionate share of defaulters.

Financial aid administrators need an expansion of professional judgment which is already granted in law to limit or at least slow borrowing for specific groups of identifiable students with discretion to allow borrowing up to the full load limits on a case-by-case basis.

Second, to prevent over borrowing delinquency and default, we must streamline consumer tests and pare down the amount of information we heap on students in the name of a good consumer disclosure.

With the help of one of our member institutions we have compiled this three-ring binder, which I won't lift for you, that contains all consumer disclosure required under Title IV of the higher education act.

In the last year, we have counted no less than eight additional proposals from the administration and members of Congress to add to this binder. The path forward on better consumer disclosure will not be found in more paperwork, but instead finding what works for students.

Third, make the repayment process and deferment process as easy as possible, possibly through employer withholding, and by implementing ways to automatically enroll students in income based repayment before they enter default.

Whether one likes the direct loan program or not, the fact remains that with one holder of all federal loans, who is the federal government, we have an opportunity to take a giant step forward in essentially eliminating loan default as we know it.

Of course, the best way to strengthen loan programs is to ensure that low income families have adequate grant funding and that includes at the institutional, state, and federal levels and were very grateful for the bipartisan support we have seen over the last few years in supporting programs like the Pell grant that keeps many low income students from having to borrow at all.

For those families that need to fall back on loans, the strongest program will be one where interest rates are fair and understandable. There are additional safeguards in place to deter over borrowing and where consumer information is streamlined. Thank you.

[The statement of Mr. Draeger follows:]

Prepared Statement of Justin S. Draeger, President and CEO, National Association of Student Financial Aid Administrators (NASFAA)

CHAIRMAN KLINE, RANKING MEMBER MILLER, AND MEMBERS OF THE COMMITTEE: Thank you for inviting me to testify today. The National Association of Student Financial Aid Administrators, known as NASFAA, represents more than 17,000 financial aid administrators who serve more than 16 million postsecondary students each year. Our membership spans more than 3,000 colleges and universities from across the nation. Collectively, NASFAA schools serve 97 percent of all federal student aid recipients.

The job of the financial aid administrator has evolved over the last five decades as more students rely on federal, state, and institutional aid and programs have become more complicated, however the core mission remains the same: to ensure that no qualified student is denied access to postsecondary education due to a lack of financial resources. We have been pleased to work with legislators on both sides of the aisle, including many of you, to ensure continued funding for Federal Pell Grants and other vital forms of federal student aid, and we look forward to working with you to strengthen the federal student loan programs.

Almost 40 million Americans—both parents and students—have outstanding student loan debt (Lee, 2013). Based on current projections, in just a few short years, more Americans in this country will have outstanding student loans than receive Social Security (Social Security, 2013) or food stamps (Food Research and Action Center, 2012). And with federal loans making up 90 percent of the total student loan market (College Board, 2012), federal student loans will soon be the largest U.S. federal assistance program. Given these numbers, it's imperative that we get

federal student loan policies right. We have a collective interest in ensuring that federal loans remain accessible, affordable, predictable, and fiscally sustainable.

Today I want to give you some of the practical insights on what financial aid administrators experience when working directly with students and parents on student loan issues. These insights will demonstrate why our current student loan policies—and how we handle interest rates in particular—aren't working well for students and families. I'll divide my comments into two parts, first focusing on student loan interest rates and second focusing on the loan programs in general.

The current structure of federal student loan interest rates is out of step with market rates and thereby confuses students and families. Students and parents often question why federal student loan interest rates are higher than nearly all other installment loans, particularly for families with good credit. And the truth is, there is no good, reasonable answer to that question.

The Federal Stafford Loan program is divided into two parts: subsidized Stafford loans where the government pays the interest on the loans during periods of enrollment and deferment and unsubsidized loans, where interest accumulates while the student is enrolled in college. Federal PLUS loans may be taken by graduate students or parents of undergraduate students if they have no adverse credit history.

The current interest rate on federal unsubsidized Stafford Loans is near 7 percent. The current interest rate on federal PLUS loans for graduate students and parents is worse, at nearly 8 percent (and this is after a 4 percent off-the-top origination fee). Families ask, how can this be? Mortgage rates are currently below 4 percent and interest rates on private education loans for borrowers with good credit are also much lower. In fact, one major lender just announced a private education loan for graduate students with no origination fees, no prepayment penalties, and interest rates between 2.25 and 7.5 percent (Sallie Mae, 2013)—all of which are better than the current terms for federal PLUS loans.

While it is true that the interest rate on subsidized Stafford loans is currently at 3.4 percent—much closer to market rates—it is equally important to understand that overall, the subsidized Stafford loan program serves only a fraction of all federal loan borrowers. In fact, half of all subsidized Stafford loan borrowers also borrow unsubsidized Stafford loans, which results in students having an annual Stafford loan debt with a portion of their loans at 3.4 percent and another portion at 6.8 percent. If financial aid weren't confusing enough, we've essentially created a situation where roughly 4 million students have basically one loan with two different interest rates (U.S. Department of Education, National Center for Education Statistics, 2007-08 National Postsecondary Student Aid Study).

The point is that few students are benefiting exclusively from the current 3.4 percent interest rate and, even after last year's temporary extension by Congress, the 3.4 percent interest rate is set to double to 6.8 percent this July.

From a public policy standpoint, it is generally better for students to borrow within the safety of the federal loan programs before using capital from private markets. The federal loan programs offer safeguards to help students avoid the dire consequences of delinquency and loan default. They contain deferment rights and mandatory forbearance options, loan forgiveness options, income-based repayment, and safeguards to protect students, parents, and co-signers against the collateral financial damage of total and permanent disability or death. And most importantly, federal student loans represent a public investment in students who otherwise wouldn't qualify for private market loans due to credit restrictions. They create opportunity.

Unfortunately, the current interest rate disparities between federal loans and private loans overshadow all of the benefits of federal student loans. This is naturally confusing to families, since financial aid administrators—not to mention required Truth in Lending Act (1968, as amended) disclosures—counsel families to use federal loans as their first option.

This interest rate discrepancy will continue to be a problem as long as we have fixed federal student loan interest rates. Prior to 2006, federal student loan interest rates were variable and changed annually based partially on the cost of government borrowing. (Interest rates were determined annually by adding on some additional basis points above the 91-day T-bill auctioned each May.) The numbers show that had we stayed with a variable interest rate in 2006, all student borrowers in the Stafford and PLUS loan programs would actually have fared better than they have under the fixed interest rates of the last six years (See Appendix).

Based on Congressional Budget Office projections (2013), returning to a variable interest rate would also save students money into the foreseeable future, since the 91-day T-bill is projected to stay at or below 1 percent through 2017. Of course we acknowledge that making a change back to a 91-day T-bill could be costly.

One of the unintended consequences of our current interest rate policy is the unexpected revenue being returned to the federal government. In Fiscal Year 2013, the

government is expected to earn 64 cents for each dollar lent to graduate students in the federal PLUS loan program, according to the Congressional Budget Office (2013). While we certainly want these programs to be fiscally sustainable, it is equally important to remember that the intent of the federal loan programs is to provide affordable and safe financing options for students who otherwise would not have had the opportunity to receive postsecondary education, and who go on to become productive taxpaying members of our society.

Unfortunately, our current student loan interest rate policy has undermined the very feature fixed interest rates were supposed to provide: predictability. For the last two years we've run up against harsh budget realities that have called into question the sustainability of fixed interest rates and made them anything but predictable.

This is the second year in a row policymakers have been left scrambling to keep interest rates down for subsidized Stafford Loan borrowers. Last year we kept interest rates from doubling from 3.4 percent to 6.8 percent for these borrowers at a cost of roughly $6 billion. To partially offset that expense, Congress reduced eligibility for subsidized Stafford loans. As has become accepted business practice, we made another piecemeal patch that took funding away from some students to provide it to others, except in this instance we provided one benefit and took away another from the same students. In effect, we robbed Peter to pay Peter!

NASFAA continues to advocate for a long-term, market-based solution to these problems by returning to a variable interest rate, where the rate is determined based on the following: the cost of government capital and origination (without any reliance on origination fees), the cost of proper servicing and loan counseling, and future market risk. This should all be underscored by the idea that at no time should federal student loans turn into a profit- making venture for the federal government. We recognize that you as lawmakers must find the right balance between benefits to students and risks to taxpayers, who are the source of this student loan funding.

Several proposals have called for a variable fixed interest rate, or an annual fixed interest rate, where the interest rate would change for new loans originated each year, but would then remain fixed for the future life of the loan. Such a policy would ensure that federal loan rates are closer to market rates while simultaneously providing some degree of predictability for current borrowers.

Of course, interest rates are only one issue—albeit an immediate one—that needs to be addressed to strengthen the student loan programs. Federal student loans could further be strengthened through some additional practical policy changes. This is the second area I would like to address today.

Despite many anecdotes in the mainstream press about the student loan bubble and runaway student debt, the majority of student loan borrowers are leaving schools with a manageable amount of loan indebtedness. Unlike the horror stories we often read, only 2 percent of students who first enrolled at a postsecondary institution in 2003 had borrowed more than $50,000 by 2009. Over 40 percent of that cohort did not borrow at all and another 25 percent borrowed less than $10,000 (College Board, 2012). Unfortunately, the hyper-focus on statistical outliers—those students who have racked up $100,000 in loans—diminishes our ability to focus on those students who find themselves most economically harmed by student loan debt.

Who are these students? If we were to build a statistical profile of the average federal student loan defaulter, he or she would likely be a student who went to school for a very short period of time, usually less than one year, accumulated a small amount of loan debt, had a low GPA, and attended either a community college or proprietary institution. Two out of every three borrowers who enroll in college for one year or less will fall delinquent or default outright on their student loans, many on less than $10,000 in total loan debt. Of all student loan defaulters, 70 percent dropped out of college (Loonin & McLaughlin, 2012).

Given these statistics, we need to examine policies that give institutions more flexibility in providing counseling and safeguards to ensure students are academically prepared, understand their loan obligations, and are able to keep loan borrowing in check.

Under current federal regulations, federal student loans are considered entitlement aid. Schools are prohibited from requiring additional loan counseling for students who appear to be over-borrowing or who are most at risk of defaulting. In addition, schools are not permitted, in any practical way, to limit part-time students from borrowing at full-time rates, or to deter students enrolled in two-year programs from borrowing up to four-year levels. Likewise, schools cannot halt or even slow over-borrowing by students enrolled in academic programs that produce a disproportionate share of loan defaults. In other words, students are currently entitled to bor-

row the maximum loan limits, and can only be deterred from over-borrowing on an individual, case-by-case basis.

Financial aid administrators, particularly at the community college level, need additional authority to limit or at least slow borrowing for specific groups of students, with discretion to allow borrowing up to the full federal loan limits on a case-by-case basis (NASFAA, 2013.). That would flip the current approach, to instead allow across-the-board reductions in loan eligibility for identifiable categories of students with expanded borrowing permitted on a case-by-case basis.

Additionally, more can be done to protect parent borrowers from over-borrowing. Since the recession, more schools are reporting instances of parents objecting to their own Federal PLUS loan approvals because they their income is insufficient to repay the debt. Current PLUS loan underwriting standards simply examine whether a parent has any "adverse credit," without considering whether a parent is financially able to repay the loan.

We would not want to mirror or duplicate commercial underwriting standards in the federal programs, since the purpose of the loan programs is to provide a public investment in college-ready students who otherwise would be unable to obtain credit. However, a simple debt-to-income ratio on parent loans would at least take into consideration a parent's ability to repay the loan based on their current income. Under the Federal Family Education Loan Program (FFELP), which has since been phased out in favor of the Direct Loan Program, some lenders utilized debt-to-income ratios as part of their parent PLUS loan underwriting standards. In the Direct Loan program that simple financial stress test is not conducted. The result is that parents with no adverse credit, or even no credit, can be approved for tens of thousands of dollars of loans without any evaluation of their true ability to repay. If the mortgage meltdown taught us anything, it is that basic and proper underwriting not only protects lenders, it also protects borrowers.

Another factor in preventing over-borrowing and loan default is loan counseling. Current loan counseling requirements seem to be based on the principle that more is better. But anyone who has ever signed a home mortgage loan knows that receiving mountains of consumer information does not necessarily improve understanding—it often has the opposite result. We must streamline, consumer test, and pare down the amount of information we heap on students and parents in the name of good consumer disclosure. With the help of one of our member institutions, we have compiled this three ring binder that contains all of the consumer disclosures currently required under Title IV of the Higher Education Act (1965, as amended). Within the last year, we've counted no less than eight additional proposals from the Administration and members of Congress for even more consumer disclosures. The path to smarter decisions on student loans and college costs will not be found in even more paperwork; it will be found through customized, streamlined, and consumer-tested information that gives students a complete picture of their student loan responsibilities and loan costs.

In many cases, averting student loan default can be as simple as making the repayment process as easy and safe as possible for students and parents. Automatic enrollment in income-based repayment would ensure that no borrower's repayment amount will ever exceed their ability to repay. NASFAA has worked with Congressman Petri to explore whether this can be accomplished through the current federal loan programs using payroll withdrawal and federal withholding. We believe we're closer than ever to being able to institute repayment pathways that ensure student loans are repaid on time and remain affordable. Whether one agrees or even likes the Federal Direct Loan program, the fact of the matter is that with one originator and holder of federal loans—the U.S. government—we have an opportunity to take a giant step forward in nearly eliminating student loan default.

Finally, the best way to strengthen the loan programs is to ensure adequate grant funding at the institutional, local, state, and federal levels. Our federal student aid programs are founded on the idea that grants, not loans, are the best way for qualified, low-income students to obtain access to higher education. Polls show time and again that the public supports continued funding of higher education and we're grateful for bipartisan support for programs like the Pell Grant. For those families that need to fall back on loans, the strongest program will be one where interest rates are fair and understandable, additional safeguards are in place to deter over-borrowing, consumer information is streamlined and delivered in a way that is easy for students and parents to understand, and loan repayment is simple and affordable.

Thank you for your time. I am happy to answer any questions.

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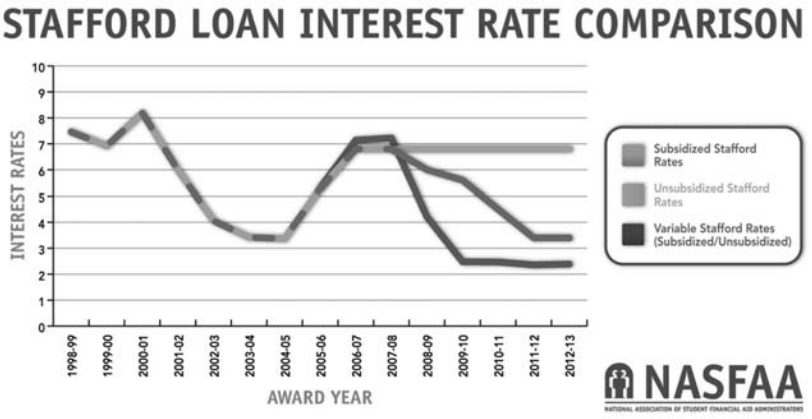
Appendix A – Stafford Loan Interest Rate Comparison Chart



Appendix B – Annual and Aggregate Direct Loan Program Limits

Academic Level	Base Annual Loan Limit for Academic Year (Subsidized and Unsubsidized Direct Loans)	Additional Unsubsidized Limit for Dependent Students Whose Parents Can Borrow PLUS	Additional Unsubsidized Limit for Independent Students and Dependent Students Whose Parents Cannot Borrow PLUS
First-Year Undergraduate	$3,500	$2,000	$6,000
Second-Year Undergraduate	$4,500	$2,000	$6,000
Third-Year and Beyond Undergraduate	$5,500	$2,000	$7,000
Preparatory Coursework for Enrollment in an Undergraduate Program	$2,625		$6,000
Preparatory Coursework for Enrollment in a Graduate/Professional Program	$5,500		$7,000
Coursework for Teacher Certification/Credential	$5,500		$7,000
Graduate/Professional	$0		$20,500
Prorated Loan Limits: Applicable to undergraduates enrolled in program less than an academic year (AY)	Annual loan limit for grade level, multiplied by the lesser of: $\frac{\text{\# of weeks in program}}{\text{\# of weeks in AY}}$ **or** $\frac{\text{\# of credit/clock hours in which student will enroll}}{\text{\# of credit/clock hours in AY}}$		
Prorated Loan Limits: Applicable to undergraduates enrolled in remaining period of enrollment less than an AY (when program length is one AY or longer)	Annual loan limit for grade level, multiplied by: $\frac{\text{\# of credit/clock hours in which student will enroll}}{\text{\# of credit/clock hours in AY}}$		

Note: *If a financial aid administrator exercised professional judgment authority for a dependent student to offer only unsubsidized Direct Loan funds because the student's parents no longer financially support the student, will not support the student in the future, and refuse to complete the Free Application for Federal Student Aid (FAFSA), eligibility is limited to the applicable base annual unsubsidized loan limit plus $2,000 per academic year in additional unsubsidized loan funds.*

Note*: For periods of enrollment beginning on or after 7/1/12, graduate and professional students are no longer eligible for Direct Subsidized Loans.*

Academic Level	Base Annual Loan Limit for Academic Year (Subsidized and Unsubsidized Direct Loans)	Additional Unsubsidized Limit for Dependent Students Whose Parents Can Borrow PLUS	Additional Unsubsidized Limit for Independent Students and Dependent Students Whose Parents Cannot Borrow PLUS
Graduate in Public Health, Masters or Doctoral Degree in Health Administration, Degree in Clinical Psychology, Doctor of Pharmacy or Chiropractic	$0		$20,500 + $12,500* *(for 9-month AY)* $20,500 + $16,667* *(for 12-month AY)*
Doctor of Allopathic Medicine, Osteopathic Medicine, Dentistry, Veterinary Medicine, Optometry, Podiatric Medicine, Naturopathic Medicine, or Naturopathy	$0		$20,500 + $20,000* *(for 9-month AY)* $20,500 + $26,667* *(for 12-month AY)*
PLUS (for parents of dependent undergraduates and graduate/professional students)	Cost of attendance (COA) minus estimated financial assistance (EFA) for loan period *(**Note:** PLUS funds are unsubsidized. Graduate/professional students must complete the FAFSA and be given an opportunity to apply for their maximum eligibility in unsubsidized Direct Loan funds first.)*		

**Increased unsubsidized annual loan limit available for certain health professions students due to phase out of the Health Education Assistance Loan (HEAL) Program. The 9-month increased unsubsidized loan limit must be prorated for programs having an academic year of 10 or 11 months. For additional information, see pages 3-92 through 3-94 of the 2011–12* FSA Handbook.

Direct Loan Program Aggregate Loan Limits

Academic Level	Aggregate Loan Limit: Subsidized Borrowing	Aggregate Combined Loan Limit: Subsidized and Unsubsidized Borrowing* (maximum subsidized)
Dependent Undergraduate Whose Parent Can Borrow PLUS	$23,000	$31,000 (maximum $23,000 subsidized)
Independent Undergraduate and Dependent Undergraduate Whose Parent Cannot Borrow PLUS	$23,000	$57,500 (maximum $23,000 subsidized)
Graduate/Professional	$65,500	$138,500 (maximum $65,500 subsidized)
Graduate in Public Health, Masters or Doctoral Degree in Health Administration, Degree in Clinical Psychology, Doctor of Pharmacy or Chiropractic	$65,500	$224,000 (maximum $65,500 subsidized)
Doctor of Allopathic Medicine, Osteopathic Medicine, Dentistry, Veterinary Medicine, Optometry, Podiatric Medicine, Naturopathic Medicine, or Naturopathy	$65,500	$224,000 (maximum $65,500 subsidized)
PLUS (for parents of dependent undergraduates and for graduate/professional students)	No aggregate limits	

**The amounts in the "Aggregate Combined Loan Limit: Subsidized and Unsubsidized Borrowing" column represent the total amount of Direct Loans that may be borrowed for the student's current program of study. If the student later enrolls in a program with a lower aggregate combined loan limit, the student reverts to the aggregate combined loan limit applicable to his or her new program. The same principle applies if the amount of a student's eligibility for the additional unsubsidized loan limits changes due to a change in dependency status from independent to dependent or a change in the inability of a dependent student's parent to borrow a PLUS. That is, the amounts under the increased additional unsubsidized loan limit do not count toward the new aggregate combined loan limit.*

Appendix C – Direct Loan Counseling Requirements

The following compilation includes all current Direct Loan Program requirements related to initial counseling (required before a first-time borrower can receive the first loan installment) and exit counseling (required when a student ceases half-time enrollment).

Counseling Requirements	Initial Counseling	Exit Counseling
Conduct with any first-time borrower of subsidized, unsubsidized, or graduate PLUS loan before releasing the first installment of any loan proceeds	✓	
May be provided in person, on written form that borrower must sign and return to school, online, or through interactive electronic means with borrowers acknowledging receipt of materials	✓	
Must take reasonable steps to ensure the borrower receives the counseling materials, and participates in and completes the counseling	✓	
Someone with expertise in Title IV programs must be reasonably available shortly following counseling to answer borrower questions	✓	✓
Provide and/or explain:		
• Use of the master promissory note (MPN)	✓	✓
• Seriousness and importance of the repayment obligation	✓	✓
• Consequences of loan default, including adverse credit reports, federal delinquent debt collection procedures, and litigation	✓	✓
• The borrower's obligation to repay the full loan amount even if the borrower does not complete the program, takes longer than normal to complete the program, is unable to obtain employment upon completion, or is otherwise dissatisfied with or does not receive educational or other services purchased from the school	✓	✓
• Examples of monthly repayment amounts based at various ranges of student indebtedness in subsidized, unsubsidized, and graduate PLUS loans, depending on the types of loans the borrower has obtained, or average cumulative indebtedness of other borrowers in the same programs of study as the borrower at the same school	✓	✓
• To extent practicable, any effect accepting the loan will have on a student's eligibility for other forms of student aid	✓	
• Information on how interest accrues and is capitalized during periods	✓	

when interest is not paid by the borrower or ED		
• His or her option to pay unsubsidized loan interest while in school	✓	
• School's definition of half-time enrollment, during regular terms and summer periods, and consequences of not maintaining half-time enrollment	✓	
• Importance of contacting the appropriate school offices if he or she withdraws prior to completing the program of study so the school can provide exit counseling, including information regarding his or her repayment options and loan consolidation	✓	
• Information on the National Student Loan Data System (NSLDS) and how to access his or her records	✓	✓
• Names and contact information of individuals to contact with questions regarding his or her rights and responsibilities or loan terms and conditions	✓	✓
• For first-time graduate PLUS borrowers, borrower's option to pay graduate PLUS interest while in school	✓	
• For each graduate PLUS borrower who has previously received a subsidized or unsubsidized loan, comparisons of maximum interest rates for unsubsidized loans and for graduate PLUS, periods when interest accrues on unsubsidized loan and on graduate PLUS, and points at which unsubsidized loans and graduate PLUS enter repayment	✓	
Must ensure exit counseling is conducted with each subsidized and unsubsidized loan, and graduate PLUS borrower shortly before he or she ceases at least half-time enrollment in person, by audiovisual presentation, online, or through interactive means		✓
If borrower leaves school without school's knowledge or fails to complete counseling, provide counseling by electronic means or by mailing written materials to the borrower's last known address within 30 days of learning that a borrower has left the school or has failed to complete exit counseling		✓
If student is enrolled in study abroad or correspondence and school chooses to provide the borrower written exit counseling materials, must mail the materials within 30 days after borrower completes program		✓
Provide and/or explain:		

• Available repayment plan options, including a description of the different features of each plan and sample information showing, for each plan, the average anticipated monthly payments, interest paid, and total payments		✓
• Option to prepay each loan, pay on a shorter schedule, or to change repayment plans		✓
• Effects of loan consolidation on total interest and fees to be paid, length of repayment, underlying loan benefits (e.g., grace periods, forgiveness, deferments, etc.), prepayment and change of payment plan options, and borrower benefit programs that may vary among different lenders		✓
• Debt-management strategies designed to facilitate repayment		✓
• General description of the terms and conditions for full or partial forgiveness or discharge of principal and interest, deferment of principal or interest, and forbearance, including forgiveness or discharge benefits available to a FFEL borrower who consolidates his or her loan into a Direct Consolidation Loan		✓
• A copy, either on paper or by electronic means, of the information ED makes available under Section 485(d) of the HEA		✓
• Availability of the ED's Federal Student Aid (FSA) Ombudsman's office		✓
• General description of the types of tax benefits that may be available to borrowers		✓
Collect borrower's name, address, Social Security Number, references, driver's license number and state of issuance (if applicable), expected permanent address, name and address of next of kin and expected employer, and provide within 60 days to the Direct Loan Servicing Center		✓
Document, for each borrower, compliance with counseling requirements		✓

Chairman KLINE. Thank you.

Dr. Mercer?

STATEMENT OF DR. CHARMAINE MERCER, VICE PRESIDENT OF POLICY, ALLIANCE FOR EXCELLENT EDUCATION

Ms. MERCER. Good morning. Chairman Kline, Ranking Member Miller, and members of the committee, good morning and thank you for this opportunity to testify today.

The title of this hearing, "Keeping College Within Reach," is both timely and appropriate for discussing various aspects of federal support for higher education, including student aid and loans.

The federal student aid system, as initially designed, was intended to ensure access to college for students who would otherwise be unable to attend. Federal aid has helped countless numbers of students pursue their higher education aspirations since 1965, when the Higher Education Act was signed into law.

The last decade has witnessed many changes to the student aid system including eliminating subsidized loans for graduate and professional students, mandatory funding for Pell, and decreasing the number of semesters for which students are Pell eligible, to name a few.

Each of these changes occurred outside of the full HEA reauthorization and, although they are seemingly small, they have had a significant impact on the cost of the program, did little to stem the

rising college costs, and in some instances, negatively changed the composition of the recipient population.

Worse yet, many of these changes have done little to halt the ever increasing and dangerous amount of debt that students assume. In fact, student loan debt is fast approaching $1 trillion, and the number of borrowers and the average amount of debt have increased by 70 percent in just 8 years.

Incremental changes in some instances are necessary and unavoidable, but by their very definition they fail to address the student aid system in its entirety.

These incremental changes have done little to respond to skyrocketing college costs and often, due to the rush to pass them, their unintended consequences are not fully explored.

The time has come for Congress to reauthorize the HEA so that it responds to the 21st century needs of students, institutions of higher education, and our nation.

A thoughtful reauthorization of this critical piece of legislation will require time, deliberation, and compromise. In the interim, other exigencies such as the pending interest rate increase on subsidized loans will require legislative action prior to a full reauthorization.

However, to the extent practicable, these types of changes should be addressed with consideration for the broader context in which they exist. For example, if the current interest rate on subsidized student loans were to double, this would have a disproportionate impact on the neediest students since they are the recipient of these types of loans.

A recent report by the Pew Research Center notes that student loan debt is 24 percent of household incomes for families in the lowest income quintile. The report states, and I quote—"The relative burden of student loan debt is greatest for households in the bottom fifth of the income spectrum, even though members of such households are less likely than those in other groups to attend college in the first place."

The nation needs a comprehensive plan to promote access, completion, and affordability for these and other students. Today, more than any other time in recent history, postsecondary educational attainment is critical for individuals and the nation as a whole.

The United States' ability to maintain its international position as an economic powerhouse requires the country to have a highly educated and skilled workforce.

The 21st century requires individuals to possess knowledge and skills that prepare them for college, a meaningful career, and economic security. Absent these skills, many Americans will remain un- or underemployed, and the nation's economy will stagnate or decline.

The federal student aid system has previously focused on access exclusively, but access alone is not enough; completion must also be a goal. Although very well-intentioned, the federal student aid system is complex and poorly aimed at getting students to finish.

Each year, there is a significant federal investment made in students at the K-12 and postsecondary education levels. However, the investment at both levels sees little return unless students complete what they start.

Failing to complete college means there is little to no return realized other than often times unmanageable amounts of debt without a degree. Changes to the HEA should be directed at the twin goals of access and completion. The reality is that all students are not equally financially equipped to take advantage of postsecondary opportunities.

It is critical that public policy maintain the focus on making higher education affordable and accessible for the lowest income and neediest students that the market might otherwise leave behind.

The Alliance for Excellent Education recently released a report based on a comprehensive examination of the federal student aid system. The paper includes recommendations for how to change many of the existing programs to create a system whose components are purposeful towards promoting access to college as well as completion.

These recommendations are a part of a broader package and resulted from thinking about the system in its entirety rather than a single aspect or individual programs.

The alliance respectfully encourages Congress and this committee to approach these issues in a similar fashion.

Undeniably, these are difficult fiscal times. However, there are no quick fixes to the nation's unacceptably low postsecondary completion rates, rising college costs, and student loan debt.

What our nation needs now is a thoughtful and purposeful consideration of postsecondary education policies. Students must continue to have access to college and be appropriately incentivized and supported to complete in order to achieve individual prosperity and to become an integral part of the nation's economy.

I thank the committee for taking on this important issue in focusing attention on keeping college within reach. Thank you.

[The statement of Ms. Mercer follows:]

Prepared Statement of Charmaine N. Mercer, Ph.D.,
Vice President of Policy, Alliance for Excellent Education

Chairman Kline, Ranking Member Miller, and members of the Committee, good morning and thank you for this opportunity to testify today. The title of this hearing, "Keeping College Within Reach," is both timely and appropriate for discussing various aspects of federal support for higher education, including student aid and loans.

The federal student aid system, as initially designed, was intended to ensure access to college for students who would otherwise be unable to attend. In fact, in his 1965 speech to Southwest Texas State College, after the signing of the Higher Education Act, President Lyndon Johnson said,

"To thousands of young men and women, this act means the path of knowledge is open to all that have the determination to walk it. It means a way to deeper personal fulfillment, greater personal productivity, and increased personal reward * * * an incentive to stay in school."

President Johnson's remarks suggest that the federal student aid system would function to keep college within reach for those who desired to attend. Since 1965, federal aid, consisting of grants, loans, work opportunities, and tax credits, has helped countless numbers of students pursue higher education aspirations.

In the nearly 50 years since the passage of the 1965 Higher Education Act, it has been fully reauthorized eight times and each reauthorization has attempted to balance Congressional and Administration priorities; mounting budget deficits; and demands from students, families, and the general public, with changes in postsecondary education, workforce demands, and the economy. Outside of the comprehensive reauthorizations of HEA, there have been numerous incremental changes, pri-

marily directed at eligibility requirements, the need-analysis formula, and increased aid limits.

The last decade has witnessed many changes to the student aid system, including several changes to the loan programs, such as elimination of subsidized loans for graduate and professional students; mandatory funding for Pell Grants; and decreasing the number of semesters for which students are Pell eligible, to name a few. Each of these changes occurred outside of a comprehensive reauthorization, and although they are seemingly small, they have had a profound impact on the costs of the student aid programs, done little to stem the rise in college costs and associated debt, and in some instances, negatively changed the composition of the recipient population.

Arguably, many of the changes that have occurred outside of a comprehensive reauthorization have been beneficial yet short sighted. For example, eliminating year-round Pell Grants allowed the maximum award of $5,550 to be maintained, but reportedly, it also significantly reduced the number of students taking additional courses during the summer—which typically leads to increased completion rates.

Worse yet, many of these changes have done little to halt the ever increasing and dangerous amount of debt that students rack up due to increasing college costs, among other things. In fact, student loan debt is fast approaching a trillion dollars, and the number of borrowers and the average amount of debt have increased by seventy percent in just eight years. Incremental changes in some instances are necessary and unavoidable, but by their very definition, they fail to address the student aid system in its entirety. These changes have done little to respond to skyrocketing college costs and often due to the rush to pass them, their unintended consequences are not fully explored.

Congress, starting with this Committee, is now positioned to thoroughly examine the Higher Education Act, including federal student aid programs, and to consider both the known and unintended consequences, and to produce legislation that continues the federal commitments to ensuring access, tackling college costs and soaring debt, and promoting completion.

Focusing exclusively on student loans—or more specifically, the interest rates on subsidized loans for undergraduate students—fails to notice the forest for the trees.

The complexities of the federal student aid system require that it be examined in its entirety. Looking solely at loans doesn't address the shortfalls of grants. Addressing the shortfalls of grants doesn't consider weaknesses in higher education tax credits. Fixing higher education tax credits doesn't, in turn, remedy the challenges and limitation of the campus-based programs. Addressing any one aspect of this system is necessary but individually, each is not sufficient for true reform of postsecondary aid programs and promoting student success and completion.

The time has come for Congress to reauthorize the HEA so that it responds to the 21st-century needs of students, institutions of higher education, and our nation. A thoughtful reauthorization of this critical piece of legislation will require time, compromise, and deliberation. In the interim, other exigencies such as the pending interest rate increase on subsidized loans will require legislative action prior to a full reauthorization. However, to the extent practicable, these types of changes should be addressed with consideration for the broader context in which they exist. For example, if the current interest rate on subsidized loans were to double, this would have a disproportionate impact on the neediest students, since they are the recipients of these types of loans. A recent report by the Pew Research Center notes that student loan debt is twenty four percent of household income for families in the lowest income quintile. The report states, "The relative burden of student loan debt is greatest for households in the bottom fifth of the income spectrum, even though members of such households are less likely than those in other groups to attend college in the first place." The nation needs a comprehensive plan to promote access, completion, and affordability for these and other students.

Today, more than any other time in recent history, postsecondary education attainment is critical for individuals, communities, and the nation as a whole. The United States' ability to maintain its international position as an economic powerhouse requires the country to have a highly educated and skilled workforce.

The 21st century ushered in a technology-driven and globally connected era that requires individuals to possess knowledge and skills that prepare them for college, a meaningful career, and economic security. Absent these skills, many Americans will remain unemployed or underemployed, and the nation's economy will stagnate or decline. In fact, Anthony Carnevale of Georgetown University estimates that 2012 marked the year when more than 60 percent of all jobs required some form of postsecondary education; further, approximately 20 million new jobs now require a bachelor's degree or higher. The federal student aid system must help the United States meet this increased demand, while continuing to ensure access.

Traditionally, the federal student aid system exclusively focused on access, but access alone is not enough, completion must also be a goal. Although very well intentioned, the federal student aid system is complex, interrelated, and poorly aimed toward the goal of finishing a postsecondary program of study.

Each year there are significant federal investments made in students at the K—12 and postsecondary education levels. However, the investment at the K—12 level sees little return unless students complete a program of study at the postsecondary level. Similarly, at the postsecondary level, if students fail to complete a program of study, there is little to no return realized other than often times unmanageable amounts of debt without a degree.

Changes to HEA should all be directed at the twin goals of access and completion. Higher education for students is an advantage that society at large benefits from. However, the reality is that all students are not equally financially equipped to take advantage of postsecondary opportunities.

It is critical that public policy remain capable of making higher education affordable for the lowest-income and most-at-need students that the market might otherwise leave behind. Increased educational attainment helps individuals achieve their personal goals, improves their surrounding community, and aids the recovery and growth of the economy.

The entire federal student aid system should be thoroughly examined with these twin goals—access and completion—in mind. This examination must come by recognizing the evolving demands of our global society and our nation's current economic status.

The Alliance for Excellent Education recently released a paper based on a comprehensive examination of the federal student aid system. The paper includes recommendations for how to change many of the existing programs to create a system whose components are purposeful toward promoting college completion. The recommendations are arranged according to four tenets:

1. creating institutional supports and accountability;
2. simplifying the federal student aid system;
3. focusing aid on the highest need students; and
4. providing support for middle class families.

In the paper, the Alliance makes specific proposals in each of these areas, but ultimately the goal of these objectives is to ensure that students get from high school commencement to postsecondary completion.

The Alliance believes that students and institutions have a mutual commitment to each other for success, with the federal student aid system helping to frame and support this relationship. Being admitted by an institution of higher education is not enough; colleges and universities must do their part to provide the ancillary supports and services that promote student success from the day they arrive on campus to the day they leave with a certificate or degree. At the same time, students must be committed to their own personal success. Students must work to be prepared, stay enrolled, and receive the postsecondary credential that they committed to pursue and were supported to receive. These two parties—institutions and students—owe it to each other to work collaboratively to cross the finish line.

The Alliance sought to change the existing student aid landscape and focus funding in a way that benefits the most students. For example, the Perkins Loan and Supplemental Education Opportunity Grant programs currently support a deserving, but ultimately narrow, student population. If these funds were redirected toward postsecondary programs that better address retention and completion and produce best practices for other higher education programs, a larger student population could be better served. Similarly, if the current $5 per Pell Grant recipient that goes to institutions were redirected toward student aid, more grant aid could be provided to the neediest students, thereby reducing the need to borrow or at least decrease the amount of borrowing.

It's important to note that these recommended changes are a part of a broader package and resulted from thinking about the system in its entirety, rather than a single aspect or individual program. The Alliance respectfully encourages Congress and this Committee to approach these issues in a similar fashion.

These are undeniably difficult fiscal times. However, there are no quick fixes to the nation's unacceptably low postsecondary completion rates, soaring borrowing levels, and debt.

How and why funds are spent deserve careful consideration toward what ultimately produces better results, that is, continued access to and increased completion of postsecondary education.

What our nation needs now is a thoughtful and purposeful consideration of postsecondary education policies. Students must continue to have access to postsecondary education and be provided with the necessary incentives to complete higher

education, achieve individual prosperity, and become an integral part of the nation's economy.

As I have mentioned, students and institutions are equally important stakeholders and there is room for appropriate balance between accountability and incentives for both groups to change behavior for the benefit of the nation.

I thank the Committee for taking on this important issue and focusing attention on keeping college within reach.

Chairman KLINE. Thank you.

I think all of the witnesses for excellent testimony and observing our sophisticated lighting system.

Mr. Delisle, you were very clear in what you thought about caps in light of the various repayment options, income-based repayment options and so forth. You were pretty clear.

I would like to hear from the other three of you, or just sort of quickly, the pros and cons of putting an interest rate cap.

Dr. Lucas?

Ms. LUCAS. Okay. Well, I believe—I agree with Mr. Delisle that putting on a tight cap is both expensive and a move back to fixed rates.

However, I think that setting a cap at a relatively higher level could be useful in protecting students from periods where interest rates are unusually high and they have trouble getting out of those loans in other ways.

So I would say that I would be happy to see no cap. I would also be happy to see a cap set at a fairly high rate, say 9 or 10 percent. I would not endorse a tight interest rate cap.

Chairman KLINE. Okay, thank you.

Mr. Draeger?

Mr. DRAEGER. When we look at an interest rate cap, the last time that we had a cap on interest rates when they were variable, we were living in a time when we didn't have widespread availability of income-based repayment.

So to us, this gets at basically keeping the cost of the loan down and there is a lot of different ways we can do that. Whether it is through cap or an upfront subsidy, or whether it is by capping the total amount of interest that could ever accrue on a loan as has been done in another proposal from a member of this committee, there is a lot of different ways we can keep the cost of the loan down, and we are open to engaging the conversation about any of those ways. It doesn't have to be just an interest rate cap.

Chairman KLINE. Dr. Mercer?

Ms. MERCER. I would say that, first and foremost, it is most important that you start from kind of what your policy goals are in terms of access and completion. So to the extent that a cap would not preclude students from being able to enroll in school and complete, if that serves that goal well, then that is at least where we should start. I am not sure if it is appropriate not to have a cap because I think a safeguard in the system needs to be present.

Chairman KLINE. And Mr. Delisle, your thought was that, with the income base repayment plan, you were in effect addressing the issue of a cap without actually putting interest rate cap in? Is that correct?

Mr. DELISLE. Sure, there are about five or six examples in my written testimony that people can look at but I just, I will give you one for example.

Consider somebody with $45,000 in debt from undergraduate and graduate studies who works in the government or nonprofit sector and earns a starting salary of $38,000 with a 4 percent annual raise.

At an interest rate of 4.9 percent on the loan, she pays a total of $22,000 on her loan over 10 years and then the remaining balance is forgiven under public service loan forgiveness.

At an interest rate of 12 percent she still pays $22,000 on her loan. If her interest rate is zero she still pays $22,000 on her loan.

Chairman KLINE. Thank you. Wow. Somehow it doesn't seem possible.

Going to you Mr. Draeger, you addressed something that I hear all the time from institutions where you have advisors who say we can't advise the student not to take this maximum loan. We know they shouldn't, but we can't do it. Do you think we can put into policy here, in a statute, a policy that would allow that and still avoid the discrimination?

Mr. DRAEGER. Sir, I think we would have to be very careful in instituting a policy where schools could limit or at least slow borrowing for groups of identifiable students.

Certainly we wouldn't do that based on any prohibited characteristics or classes; race, sex, religion, national origin, those things have to be specifically prohibited. But there are concrete examples, I think, where schools and particularly low cost institutions would very much like the ability to at least introduce additional counseling over and above the minimum federal requirements or prohibit borrowing, perhaps for all students at an institution, for part-time students, for students in specific academic programs where we know the outcomes may not support the level of debt that they are taking on.

Schools would welcome that authority so that they could perhaps be a check and a balance for students to make sure that they are not getting in over their head.

In sort of a conflict, schools are held responsible for the number of students that default on their loans and they are also held responsible at least in public and in the press by how much debt to their students take on, yet they have very few if any tools at their ready to address that in any meaningful way.

Chairman KLINE. Thank you.

Mr. Miller?

Mr. MILLER. To continue on that line of question, Mr. Draeger, so you would counsel them how? I mean your institution is offering this course of study for this credential or this degree and you would counsel them, don't do that?

Mr. DRAEGER. So, for example, right now, if we look at the statistics, the average statistic of a borrower who has defaulted, it is not normally what you hear in the press. The stories in the press usually revolve on a statistical outlier, someone who has racked up tens of thousands of dollars of debt and we know the average amount of debt is much less.

If you look at the defaulted borrower, people in student loan default, 70 percent of them have dropped out of school normally in the first or second year and it doesn't seem fair for students that may not be academically prepared to load them up with debt without some additional counseling over and above current, minimal federal requirements.

Right now if an institution tries to institute additional counseling over and above what the——

Mr. MILLER. I understand that, but you had suggested also that you may not want them to engage in some courses or curriculums because they have a high default rate.

Mr. DRAEGER. What we would say is——

Mr. MILLER. Why are you offering those?

Mr. DRAEGER. If there is a program, for example, where we know—let's use teacher education or childcare. In some states that is a license requirement that they have to get a certification, but the amount of loan debt that they are taking on isn't going to be supported by their wages.

If they could provide some additional counseling——

Mr. MILLER. So it is not a question of whether they pursue that occupation or credential, it is a question of what is the appropriate loan—or they should certainly be advised of the chances of repaying this loan or for getting into trouble given the low pay of childcare workers if you will.

Mr. DRAEGER. That is correct.

Mr. MILLER. Okay. It is not that you have curriculums out there and you don't jettison but you don't think people should take them. I wasn't quite sure——

Mr. DRAEGER. No. The other example, Mr. Miller, is examples of part-time students who may be running up their loan amounts at a full-time rate which schools right now can't stop and so they run out of loan eligibility.

Mr. MILLER. Why is that happening? Because they are working? Because they are doing what?

Mr. DRAEGER. It could be because of work. It could be because they don't recognize the amount of loan debt that they are taking on despite minimal warnings, but right now, those students—or it could be because they are transferring in from another school where they have taken on a significant amount of debt.

Mr. MILLER. I think again, in my state, I think the community colleges are getting much more specific about what you need to do to complete and what you need to do to complete essentially in 2 years. Now whether courses are available or not we all know is a problem.

And the question is, are people borrowing money to follow this track to get the lower division requirements taking care of so that they can transfer or get a credential or get a badge or whatever it is they are pursuing, and are they on track, and is this loan amount appropriate.

Because it goes to what Mr. Mercer raised, this question of completion, and I don't think we should punish part-time students. I don't think you are suggesting that, but we know that some students have to struggle whether they are borrowing money or not

because they may be supporting themselves, working and the rest of that.

So Mr. Delisle says well if they knew—if they could see—if they knew more about loan forgiveness up front, they might make a different decision. Is that what you are—is that correct?

Mr. DELISLE. Yes, and I don't think they need to have very optimistic—they can have even very optimistic assumptions about their future earnings and still be fairly comfortable in borrowing a lot of money and ensure that it will be forgiven.

I should point out, though, this is only for graduate students because there are no limits on how much they cannot borrow on the federal student loan program.

Mr. MILLER. We are not going to weave this all in my question here, but I think the three of you are hitting essentially on the same points. And I am going to start with the idea of completion because absent completion then we do have a problem. We have high debt and nothing, essentially nothing to show for it.

But the question of then how do you make that flexible enough for those students—we will continue to pursue this, but you know, I also think the colleges, certainly community colleges, have to put more as to what is it that you are doing here and what do you want to accomplish.

Because I think having people wander around and continue to borrow money without some sense of a goal—I understand people change their majors, their ideas. I did 100 times—of course if have any major you can come to Congress, so it worked out well.

This is how I get myself into trouble. Okay, let's start over again. But I think the institutions have to play a role here too in terms of guidance about what really happens at the end of this process and are you on track or not.

Are you now borrowing your third—what would be your third-year scholarship money and you are still about a year—you know, you are still 6 months away from completing your second year. Is that the kind of counseling are talking about?

Mr. DELISLE. I think that kind of counseling is needed and hopefully is occurring on most campuses. What we are talking about is saying could we stop somebody from borrowing so that they would end up running out of loan funds before they reach the end so at least they would have some mandatory additional counseling or at least recognize. Right now a school can send out a disclosure but that doesn't necessarily mean the student has read it.

Mr. MILLER. Okay, thank you.

Chairman KLINE. Thank you.

Mr. Petri?

Mr. PETRI. Thank you, Mr. Chairman. I would like to commend you for scheduling a hearing on this important and pressing issue for an awful lot of people in our country.

We all have far too many constituents, particularly young people, struggling with student loans and I am glad that you are taking the time to take a look at this important issue.

As almost everyone is aware, the default rate on federal student loans is very high. According to recent statistics, roughly 13 percent of borrowers will default within 3 years of entering repayment.

Default can be financially ruinous for anyone, but particularly young people just getting started.

Mr. Draeger, I was struck by the portion of your testimony that was just referred to recently that described the typical characteristics of students who default. Though much of the media attention is focused on the level of student borrowing, no doubt an important issue, it is striking how many students default on manageable levels of debt.

And when one looks at our current student loan system, it is easy to see how so many students could fall through the cracks. We have rightfully recognized that student loan borrowers face many ups and downs during their career. We have added a wide array of protections, numerous deferments, forbearances, repayment options, and so on in recognition of that.

But in doing so, we have created a system that is so complex that it can be baffling even for the policymakers who work with it every day, let alone students trying to navigate it for the first time.

While certainly not a solution to all of the problems we face with student loans, I have always felt that simple, universal income-based repayment has the potential to accomplish the goals of the various protections we have created but in a way that is intuitive and automatic for borrowers and doesn't force them to navigate our current labyrinth of paperwork and bureaucracy.

Many students who will fail to navigate the current bureaucracy and fall into default despite the fact that they could have repaid their loan under a system that was more responsive.

So Mr. Draeger and Mr. Delisle, in your respective organizations, recent reports about reimagining federal student aid, each of you recommended making some form of income-based repayment as the sole or automatic method of repayment for federal student loans. Could you elaborate on the thinking behind your respective recommendations and what you think the benefits of income-based repayment would be?

Mr. DELISLE. I will go first here. Well we know that borrowers currently have a wide range of options that they can choose to repay their loans. They can choose consolidation, which extends the repayment term all the way up to 30 years. There is income-based repayment, income contingent repayment. There is 3 years of forbearance for everybody.

But, when you look at the data of what percentage of people are in what repayment plans and they are all repaying their loans under this standard 10-year repayment plan which is a pretty good signal that people aren't availing themselves of all of the benefits of these programs.

And to the extent that default or difficulty in repaying is a function of they don't have the money to pay because of their income, then getting people enrolled in income-based repayment should address that problem.

Now I should point out—and that is why we recommended that students, everybody be put into income-based repayment and one of the reasons why we propose this is that if 10 percent or 15 percent of income is the right percentage of somebody's income, if they are low income, for paying their student loan, then it has got to be the right percentage for people who have a high income.

And right now, it is the people who have high incomes who don't use income-based repayment because we have other repayment plans that are more generous for them. So we have got essentially a regressive student loan repayment plan.

Mr. DRAEGER. I would say from an institutional perspective, it is extremely frustrating is that Congress has put into place so many protections to keep students out of default, yet we have so many students that default.

The current national average of defaults in this country is around 13 percent, higher if you took the entire portfolio, and nearly every one of those students that went into default could have avoided it if they had utilized the deferment, forbearance, and income contingent options available to them.

What automatic IBR, income-based repayment, does is place students in a situation where their loan payments will always be reasonable, they will always be protected from the dire consequences that come with student loan default.

Chairman KLINE. Thank you—yes?

Mr. MILLER. May I ask for unanimous consent to include in the record of the comments by students from the Association of Michigan State University, from American University, and from the National Campus Leadership Council?

[The information follows:]

MEMO

Date: March 12, 2013
To: Andy MacCracken, Executive Director, National Campus Leadership Council
From: Evan Martinak, Chairperson ASMSU
RE: *Student Loans and Debts*

Student debt is harmful students in a number of ways. Current undergraduate students who are borrowing are faced with annual tuition increases and rising costs associated with living expenses. These costs can ultimately lead to the accruement of more debt for those who are unable to have the full cost of tuition and related expenses covered by federal loans.

Nationally, student debt levels have eclipsed $1 trillion dollars, surpassing credit card debt and all other forms of private liabilities.

As with most schools in the current higher education system, many Michigan State University students rely on Stafford loans to carry them through their degree attainment. As of 2011, 45% of college graduates from Michigan State University have, on average, accumulated $23,725 worth of college related debt. Such high debt levels can severely hinder a student's ability to attend a post-graduate institution or to complete any unpaid internship. High levels of unpaid debt also serve as a liability in the event of personal bankruptcy, as individual college debt is incredibly difficult to reduce in such an instance.

When parents cannot afford to accept PLUS loans, the standard federal loan for parents with dependant children attending college, Stafford loans make it possible for thousands of students to attend MSU. In FY 2010-2011 and academic year, MSU lost about 40 million in funding from the state government. This forced MSU to increase tuition by 6.9% to cover the cost of lost funds. With state and federal aid decreasing, the availability of loans makes an integral difference to overall affordability of an MSU degree.

All of Michigan State University's current Stafford Loans are disbursed with fixed interest rates. Had Congress not acted in 2012, interest rates on such loans would have doubled. Yet these interest rates and types of loans are not applicable to every student debtor, and thus more action would be welcomed in reducing individual student debt on an even larger scale. Low and fixed interest rates for student loans are better borrowing options than private loans, and with interest rates only fluctuating from 1-3% on average, it does seems rational to request a continuation of these low, fixed rates.

The Associated Students of Michigan State University (ASMSU) has several initiatives to try and lower costs for MSU students. Currently, ASMSU is pursuing leg-

islation that would allow local businesses of East Lansing to have no sales tax on textbooks during the beginning of semesters, in order to encourage local commerce and lower costs for students. ASMSU also offers interest free loans of up to $300, free blue books, free iClicker rentals, and free legal services to help settle some of the financial burdens associated with college. With students being dependent on these services and Stafford loans, it is imperative that the student government continues to emphasize the importance of low interest rates to provide every student with the best educational opportunity and experience.

OFFICE OF THE PRESIDENT
Memorandum

To: Education and the Workforce Committee
From: Emily Yu, President, American University Student Government
Date: 12 March 2013
Subject: *Student Loan Interest Rates*

College affordability has been an increasing concern for students at American University, and all campuses across the country, since the recession. My peers and I all realize that student debt has accumulated at unprecedented and uncontrollable rates. This not only poses a significant burden on us while we are in school and for our foreseeable young adult lives, but it also restricts the opportunities we are able to take in our careers, as we must think about finding jobs that will support us enough to may our loan repayments.

Students spoke out last year to keep interest rates from doubling for a multitude of reasons: because we realize the growing costs of higher education are not sustainable and that the federal government should have a key role in providing affordable and accessible education. The doubling of the rate would have set an uncertain precedent for us and future generations of college students, as we would no longer have the option of low interest rate Stafford Loans to help us get over financial barriers to our institutions. Additionally, students depend on the fixed rate federal loans to make long-term plans for their finances. Whereas private loans have shown to contribute much more to harmful borrowing for students, this makes fixed rate federal loans even more critical in being a financially feasible and healthy borrowing option for students.

Student debt is an issue we must all tackle together; the federal government, private institutions, and students alike need to all take action because we share the responsibility. American University is one such private actor making the hard decisions in order to ensure affordable education for our students. This year, the university administration, aware of growing national trends and the criticism its received in the past of being ranked a high debt school, took serious action to correct this wrong and to prevent future accumulation of debt on its students parts. The university administration engaged students in its budget process for the creation of the FY 2014- 2015 budget. In the end, we achieved the lowest tuition rate increase in 40 years and a $1.46 million increase in financial aid. When legislators and decision makers work with students, we can all achieve our shared goals.

There are so many reasons as to why ensuring that student loan interest rates stay low is important to all parties. For students, loan interest rates determine our ability to afford to attend our institutions, they impact the quality of our lives after graduation, and they affect our abilities to pursue certain careers and other life goals for years to come. For institutions of higher learning, their efforts to reduce costs, such as those demonstrated by American University, need to be matched by federal government action in order to have the largest impact possible for its students. And for you, our nation's legislators, it is crucial that we invest in opportunities for us, the nation's youth, so that we are able to keep moving our country forward.

Summary of Student Perspectives on Student Loans

Prepared by the National Campus Leadership Council for the House Committee on Education and the Workforce

INTRODUCTION

With student debt skyrocketing, student leaders around the country have consistently put college affordability at the top of their campus agenda. The National Campus Leadership Council (NCLC) works with 300 student body presidents, who collectively represent 4.5 million students and every state. Over the last year, NCLC has sought to better understand prevalent perspectives among campus leaders and help

share those views to inform policymakers and opinion leaders as they shape the national discourse.

On May 1, 2012, NCLC released a letter drafted by two student body presidents and signed by 280 of their peers around the country urging action to prevent student loan interest rates from doubling. To our knowledge, no other issue has sparked such united action among so many student governments nationally. It is important to note that the letter's signatories urged the freeze on Stafford loan interest rates as a "first of many steps in a real effort to address the level of student debt and reduce the excessive need for borrowing."[i]

Our team hopes that the any actions or recommendations by the Committee on Education and the Workforce are next steps toward student-driven, comprehensive improvements to the federal financial aid system. Students are particularly interested in helping create a more permanent solution to ensure student loans are affordable and open access to higher education for more young Americans. Student perspectives on student loan reform are summarized below.

Campus Perspectives

The following are prevalent ideas among student leaders around the country, which should be considered as Congress identifies a more comprehensive solution to keeping student loans affordable and college financially accessible.

I. The federal financial aid program, including loans, must be student-driven

Students leaders have experiences and perspectives that are critical to identifying practical steps forward. Most student body presidents are working with their university administrations and state legislators to keep costs down and public investment high. These efforts are important to consider when shaping federal policy. Whenever possible, young voices need to be a part of the conversation.

At public and private institutions alike, high student engagement yields decisions that better serve student needs. Emily Yu, student body president at American University worked closely with administrators this year to achieve the lowest tuition rate increase at the school in 40 years and a $1.46 million increase in financial aid. She said, "When legislators and decision makers work with students, we can all achieve our shared goals."[ii] If these efforts can be successful at the campus level, the federal government should work with student leaders to make sure programs reflect modern student needs.

II. Debt burden and repayment options must be clear and predictable

A frequent observation among students is that financing college is complicated and at times overwhelming. The fixed rates of the Stafford loan program have been important to helping students better understand their long term finances, while variable rates often offered by private lenders are difficult to understand and present significant financial challenges to young Americans as they graduate and start repaying loans.

Xavier Johnson, student body president at University of Texas San Antonio said, "Fixed interest rates present an option that is easier to plan for, so in the long run, fixed rates will be the most effective in keeping the costs to students low."[iii] These sentiments are echoed around the country among student leaders. Predictability helps students plan for repayment long term, which is why private loans, which typically have variable rates, result in higher default rates.

III. Low interest rates make a difference

When interest rates were scheduled to double in 2012, students were at risk to owe an extra $1000 for the same loan and education. The intensity of student response demonstrates what $1000 means for a college student or recent graduate. As default rates rise and high youth unemployment rates linger, the financial aid system should do all it can to minimize debt burden and make sure graduates' discretionary income is going into the economy instead of repaying loans. Making federal loans more attractive than private, sometimes predatory lending through low interest rates should be a goal of the Stafford loan program, offering safe, viable options for student borrowers.

At the University of Iowa, where the class of 2012 graduate with an average of $26,296, student body president Nic Pottebaum asserts that higher interest rates result in reduced graduation rates as students take on more debt.[iv] Indeed, this holds with national data that indicate about thirty percent of student borrowers drop out of college. As the need for a college education grows with tuition, students are forced to work through school.

The sequester will cut up to 70,000 Federal Work Study positions, adding financial stress and creating a greater need for student borrowing for lower income students.[v]

IV. Student debt is not just a student issue

Student debt negatively affects companies trying to sell goods and employers trying to fill jobs. The economy already sees the effects of overwhelming debt burden as recent graduates have to pay of loans instead of make major life decisions to buy a home or start a family.[vi] A recent Wall Street Journal article described a relatively new aversion among young people to any type of debt, including liabilities from credit cards, mortgages, and car loans.[vii] Additionally, homeownership among young people is at a thirty year low, largely driven by burdensome student debt.[viii]

Nic Pottebaum, University of Iowa, noted that "[High debt] can permanently destroy these hapless student's credit scores or permanently sentence students to a life of disappointment if they cannot graduate for financial purposes."[ix] These problems, when concentrated on our generation, present significant challenges to our generation as consumers and affects the rest of the economy. Xavier Johnson from UT San Antonio said "Debt levels can persist well into and beyond the time a graduates reaches the age of thirty. This means that money that could be going into investments, savings, or consumption is instead going to repay debts; which in turn creates a lower standard of living for graduates."[x]

Conclusion

Student debt is an overwhelming problem for students around the country and threatens important aspects of our economy. Accordingly, the federal student loan program should reflect student needs, promote predictability, and remain affordable. As student leaders noted in the 2012 open letter urging a freeze on Stafford student loan interest rates, "There has long been a promise that, if a student goes to college, works hard, and does well, they will have a more prosperous future ahead of them. Student loan debt is severely undermining that prospect." As young people we need our elected leaders to take steps necessary to secure our future prosperity and the long term health of the American workforce.

ACKNOWLEDGEMENTS

Several student body presidents sent NCLC memos detailing their campuses experiences with student loans. They include Emily Yu from American University, Jeanne Wilkes from Delta State University, Evan Martinak from Michigan State University, Ryan Beck from Missouri University of Science and Technology, Nic Pottebaum from University of Iowa, Ashley Mudd from University of Louisiana, and Xavier Johnson from University of Texas San Antonio. Their contributions, in addition to countless interviews over the last 10 months, shaped this summary.

ENDNOTES

[i] "Student Loan Interest Rates." 2012. *http://www.nationalcampusleaders.org/student-loan-interest-rates*

[ii] Yu, Emily. "Memorandum: Student Loan Interest Rates." American University Student Government. 12 March 2013.

[iii] Johnson, Xavier. "Memorandum: Student Loan Interest Rates." University of Texas San Antonio Student Government. 12 March 2013.

[iv] Pottebaum, Nicholas. "Student Loan Interest Rates: University of Iowa." University of Iowa Student Government. 12 March 2012.

[v] O'Sullivan, Rory and Brian Burnell. "Millennial Unemployment: Drops to 12.5% but Sequestration Could Increase It." Young Invincibles. 8 March 2012. *http://younginvincibles.org/2013/03/millennial- unemployment-drops-to-12-5-but-sequestration-could-increase-it/*

[vi] Shellenbarger, Sue. "To Pay Off Loans, Grads Put Off Marriage, Children." Wall Street Journal. 17 August 2012. *http://online.wsj.com/article/SB10001424052702304818404577350030559887086.html*

[vii] Shah, Neil. "Young Adults Retreat from Piling Up Debt." Wall Street Journal. 6 March 2013. *http://online.wsj.com/article/SB10001424127887323293704578334761823150672.html*

[viii] Thompson, Derek. "The End of Ownership: Why Aren't Young People Buying More Houses?" The Atlantic. 29 February 2012. *http://www.theatlantic.com/business/archive/2012/02/the-end-of-ownership- why-arent-young-people-buying-more-houses/253750/*

[ix] Pottebaum, Nicholas. "Student Loan Interest Rates: University of Iowa." University of Iowa Student Government. 12 March 2012.

[x] Johnson, Xavier. "Memorandum: Student Loan Interest Rates." University of Texas San Antonio Student Government. 12 March 2013.

Chairman KLINE. Without objection.

Mr. MILLER. Thank you.

Chairman KLINE. Mr. Andrews?

Mr. ANDREWS. Thank you, Mr. Chairman. One comment I would make about the discussion of income contingent repayment is we have two federal policies working at cross purposes.

We claim we want students to take advantage of income contingent repayment, but the gainful employment rule that was proposed does not give institutions credit for a loan being in repayment if the student chooses that option which is I think a pretty contradictory view.

Dr. Lucas, I want to ask you about your proposal to switch to a different accounting method for student loans, for direct student loans at least, and this is a very abstruse, theoretical debate that has enormous consequences in the real world in which we live.

I looked at the chart that you put at the bottom of page four. If we stuck to the present system, in the 10-year window between 2010 and 2020 the loan program is scored as raising $96 billion, reducing the deficit by $96 billion.

If we switch to your method, it would be scored as adding $140 billion to the deficit. So this is a very big deal. It is a quarter of a trillion dollar difference over a 10-year period, which has profound policy implications for how much we charge students and families and what impact it has on taxpayers. So I wanted to get into and understand the theoretical underpinnings of this.

You say that the present system fails to account for the full cost of the risks associated with government credit assistance. That is the core of your argument. So in a sense, I think you are arguing that the projections that we make based upon present discount rates and default rates and whatnot understate the cost and overstate the benefit which therefore makes them inaccurate.

But we don't really have to have a theoretical argument about this. Since 1993, at least a third of the loans in the system have been direct student loans. What has that 20 years of history actually produced on a cash basis with respect to direct student loans?

In other words, if we added up the defaults that the taxpayers had to cover, the administrative costs the taxpayers have borne, and then subtracted from that or I guess subtracted from that, the revenues that have been collected on direct student loans and also the interest cost—we have to subtract that out—what is the cash scoreboard over the 20-year basis?

Ms. LUCAS. Okay. So to address the general issue, I just want to say a word about the concept——

Mr. ANDREWS. If I may though——

Ms. LUCAS. Okay, on the cash basis I can't give you the number. It is certainly true that the cash payments have probably covered the cash outflows from those programs.

Mr. ANDREWS. Well, if we just go back to that than for a minute. If you have that information, if any of you have that information, it would be great if you could supplement it for the record.

I truly appreciate the fact that there is a theoretical difference between cash and an accrual basic counting. I don't quite understand it, but I know there's a theoretical difference.

But I think I just heard you say that if you add up over the 20-year period, the revenues that came into the federal treasury on direct student loans and subtracted from that the loan defaults the taxpayers had to cover, the administrative costs we had to cover,

and the interest we paid to acquire the funds to make the loans, that we are running a surplus on that. Is that right?

Ms. LUCAS. When the government makes a loan, they are incurring a liability to taxpayers and that liability has a cost today. That is the logic of the accrual accounting.

Mr. ANDREWS. If I may, I get the theory, but my narrow question here was on a cash basis, I think I just heard you say that the direct loan program has produced more dollars in income than it sent out in spending. Is that correct?

Ms. LUCAS. I don't have those numbers before me. I believe that if you were to account for credit on a cash basis, which I think would be a bad idea and it is not the law you would come to a different conclusion, but that accrual is the right way to think of it.

Mr. ANDREWS. I understand—no, I appreciate the theoretical difference. Just for those of us who are not economics professors, one way I would look at this is that the core of your position as I understand it is that it costs us really more to run this program then the present accounting method reflects.

Well, I would like to look at what the actual facts are in that over a 20-year period. And it is my understanding—and I—again, please supplement the record, but it is my understanding if you add up the loan payments received and you subtract from that the cost of acquiring the capital, the administrative costs of running the program, and the defaults taxpayers had to cover, the treasury has come out ahead on that. Is that true?

Ms. LUCAS. The fact is that the government gives students loans on terms that are far more favorable than what the private sector is willing to offer them, but at the same time, the government books those loans as showing a significant profit. And so there is a disconnect between thinking that the market price of the loan is one thing and the cost to the taxpayer is another thing.

If we were to buy a tank for $50 instead of $1 million we can't set the price of tanks—we can't set the price of loans.

Mr. ANDREWS. I will say I know the Defense Department is glad that we don't use that in accounting. I am not sure we should use it on students either.

Chairman KLINE. Dr. Foxx?

Ms. FOXX. Thank you, Mr. Chairman.

Mr. Draeger, what is the most important benefit for students in the federal student loan programs? A low interest rate on the front end, or repayment options and other assistance on the backend?

Mr. DRAEGER. Unfortunately, we would have to go off of anecdotal information on this because we don't have any statistical studies that show what is most important to students beyond the fact of the availability of the dollars.

That is what is covering the cost of their education. So there is little evidence to prove that interest rates, particularly since half of our subsidized Stafford loan borrowers are also borrowing unsubsidized Stafford loans at double the rate, or that interest subsidies in and of themselves up front are really driving college access.

More it seems to be that it is the availability of the dollars which is, that is what is most important to them up front and then our job is to figure out how we implement some sort of safeguards to

make sure that those students stay on the straight and narrow path of repayment.

Ms. FOXX. Thank you very much.

Mr. Delisle, you look like you wanted to make some comment after Mr. Andrews' comments and I wondered, did you want to respond?

Mr. DELISLE. I did and I now have the distinct advantage of making those comments now that he has left the room.

What Congressman Andrews was essentially purporting is that we should measure risk looking backwards when we know what already happened. That is a ridiculous concept. Most of the cost to the federal student loan is the risk of that they might not be repaid or we might not know how much they will be repaid.

And by saying, well, can't you just look at what happened and then value it? That is essentially—you wouldn't value the cost of insurance going forward based on essentially that happened—something that did or did not happen in the past.

This is another example for—you can look at a well-known program, the troubled asset relief program. So going forward, we know when we made those loans, when Congress made those loans to investment banks, we knew that we were subsidizing them. We were making rates at half the going rate in the market at a time of incredible market turmoil.

When looking backward, we got all the money back. So was it a cost or was it not cost? I would imagine most people here would say making loans to investment banks at half the going market rate is definitely a cost even if you collect everything they said they would pay you.

Ms. FOXX. Thank you very much.

Now I would like to ask each witness if you would answer this question: as the committee begins to reauthorize the Higher Education Act, what are some key principles that should guide how we review and reform federal student aid programs?

Please keep in mind we probably have about 3 minutes and there are four of you. So if you could do about 40 seconds, maybe we could get to everyone and we will start with Dr. Lucas and go down.

Ms. LUCAS. Thank you. I will say very briefly that I think what is important is to maintain the broadest of access to higher education and affordability.

In the interest of maintaining affordability, it is important to rethink student loans as well as other assistance. I think we have to think about controlling costs in a way that is not so prescriptive as it diminishes the high quality of higher education in the United States, which has really been an engine of mobility and growth in this country.

Ms. FOXX. Thank you.

Mr. DELISLE. I will be very brief. I would say do not allow graduate and professional students to borrow an unlimited amount of money with the option for loan forgiveness on the backend.

Ms. FOXX. Very good. Thank you.

Mr. Draeger?

Mr. DRAEGER. The principal that we adhere to when examining the student financial aid programs is that no qualified student be denied access to higher education due to lack of financial resources.

It may not mean choice to every school, that we will pay for every school, but basic access to postsecondary education.

Ms. FOXX. Thank you.

Dr. Mercer?

Ms. MERCER. Thank you. I would say the twin principles are both access and completion; focusing on one without the other doesn't serve us well. Students reap the biggest benefits, the nation reaps the biggest benefits when students enroll and complete college.

Ms. FOXX. Thank you, Mr. Chairman. I yield back.

Chairman KLINE. Thank you.

Mr. Scott?

Mr. SCOTT. Thank you, Mr. Chairman.

I would warn the witnesses that there is a monitor in the back so that somebody who has left may still be able to hear what is being said.

Mr. Draeger, following up on your statement about denying access, what portion of students now do you think cannot attend college because they can't afford it?

Mr. DRAEGER. The number one cited reason in study after study of why students don't go to college, whether I think both perceived and real, is lack of funding to attend.

So students either feel that they don't have enough money to attend, they come from a background that won't allow them to attend, and even if they are academically prepared, the number one obstacle that is cited over and over again is the cost.

And so whatever we can do to let students know about the availability of funds like the Pell grant program, student loans, Federal work-study, supplemental grants, I think we will continue to make strides in college going rates.

Mr. SCOTT. What portion of students would like to be on the work-study program that can't get on because of insufficient funding?

Mr. DRAEGER. The work-study program is a very popular program on college campus. And a couple of years ago we saw an increase in work-study dollars. Schools were very excited to be able to put that to work.

Work-study has the added benefit of helping students complete because it actually integrates them into the campus. So it is one of the more popular programs that schools like to administer.

Mr. SCOTT. And are Pell grants at a sufficient level to guarantee access?

Mr. DRAEGER. Our supposition is that we have appreciated the bipartisan support for the Pell grant funding. We think Pell grants could always see an increase. They have not kept pace with the cost of college and in the past have not kept pace with basic costs of inflation; recognizing that you all have to balance understanding balancing of budgets along with that.

Mr. SCOTT. Several months ago, there was a change in the PLUS Loan Program. Can you tell me the effect that had on student financial aid administrators?

Mr. DRAEGER. In the fall, we understand that the Department of Education introduced an additional underwriting criteria that looked back approximately 60 days to see if there were any delinquencies in a parent's credit or if they were delinquent on any other federal loan payment.

That resulted in denials of PLUS Loans for students who were already admitted and enrolled, and I think this gets to the point if we want to continue to not disrupt students and their ability to attend college, any changes, dramatic changes we make in the availability of financial aid ought to be done in the future for new students who are getting aid or new borrowers.

Mr. SCOTT. What portion of students were adversely affected by that change?

Mr. DRAEGER. I don't have those numbers at my disposal, but I can look to submit them for the record.

Mr. SCOTT. Thank you.

There are a number of proposals on the table. Do any of them allow you like a mortgage to midstream lock-in a set flat rate, a fixed rate, like you can a mortgage rather than a variable rate that fluctuates with the market? And would that be a good idea?

Ms. LUCAS. I believe that the proposals for introducing market-based rates would preserve the fixed rate. Many of those proposals would preserve the fixed rate nature of the loans so if the student had 20 years to pay it would be at a fixed rate that was determined in the year they took out the loan.

The change would be that loans that were originated in different years would bear different interest rates that moved along with market interest rates.

Mr. SCOTT. But there would not be a variable interest rate on the individual loan? It wouldn't go up and down with the market?

Ms. LUCAS. No, just like you said, as with a mortgage, students would get a fixed rate and they would have the option to prepay it. So if they had the opportunity to refund at a lower rate——

Mr. SCOTT. How do mortgages reset their interest rate every couple of years?

Mr. Delisle, if you don't have a discharge at the end of income based repayment, wouldn't some people be paying virtually for the rest of their lives?

Mr. DELISLE. Oh, sure, and we haven't recommended that you do away with loan forgiveness. We said it's the combination of unlimited borrowing authority for graduate students plus three limits on repayment.

One of them is loan forgiveness at 20 years or 10 years. Another is between zero and 10 percent of their adjusted gross income, and the other limit is another limit for high income earners that the payment stops going up.

If you have unlimited borrowing up front, three separate limits on the back, that is essentially a great big moral hazard and a message to students to borrow away.

Mr. SCOTT. Thank you, Mr. Chairman.

Chairman KLINE. Thank you.

Dr. Roe?

Mr. ROE. Thank the Chairman for having this and the members for being here.

I am gonna—there are some of us that are the same vintage that I am here and I want to go back in time a little bit and just express to you I came from a family that, my father worked in a factory, my mother was a bank teller. I was able to go to college. I worked. Remember the time when you worked your way through college? I was able to go to college and medical school and graduate in 7 years from both of those with no debt.

Now think about that today. I have served as a foundation board member of two colleges where I attended—the one where I attended and was president of the foundation board to help students make it more affordable and I continue to serve on the foundation board now.

And I think it is one of the greatest challenges we face in America today are the student loans and the cost of college and I don't know what is causing it to go up at seven, eight, and 10 percent per year, but it is unsustainable. I can tell you that.

You cannot go out and see young people—I see students graduate from graduate school and law school and medical school with $200,000, $250,000, $300,000 in debt. It is unbelievable and they will be 50 years old or older paying that off.

Where we live in Tennessee you can certainly buy a very nice house for what the cost of many student loans are today and these—and I see them in people who are teachers that are going out with $50,000 and $60,000 and $70,000 loans. I don't know how they ever get out of that and I think your point about no—on the other end—I think you made your point very, very well.

I am going to ask a couple questions. One, we have got a trillion or so—y'all have told us approximately $1 trillion which now exceeds credit card debt in student loan debt. Is the bubble out there? And the number I read, 35 percent of students who are paying those, or loan recipients it says here, are paying those back are 90 days and above in arrears now.

Is that bubble real? And what happens when it collapses to the taxpayers? Any of you can take that.

Mr. DELISLE. Well, I will point out of that trillion dollars that is outstanding, the median monthly payment is $190. That is from the Federal Reserve Bank. The median monthly payments on student loans is $190, monthly payment $190.

But, I also want to point out that you talked about somebody with $200,000 in debt paying for 30 years. Not under current policy. That person wouldn't pay for longer than 20 years under the income-based repayment plan.

They could choose to pay for 30 years by not enrolling in income-based repayment, but I think that the program is set up now where you can even earn a very high income and have that debt forgiven.

So our proposal was to essentially move the loan forgiveness for people who borrow more than $40,000 from 20 years to 25 years. It doesn't sound like a big change, but it is a really big change for people who go to graduate school and it essentially requires them to pay a little bit more because they borrowed a little bit more.

Mr. ROE. I guess the problem I have with that is to—here you are at 50 years old paying off a student loan that you acquired and I think certainly from the standpoint of the counselors at the school

is to let the students know what you are getting into, what you are going to pay off later.

There is a cost out there and I certainly think you need to do a better job of allowing an 18-year-old, a 19-year-old, or a 20-year-old say, hey, look, this money is going to have to be repaid and that colleges are going to have to do a better job in controlling the cost because as I said, no one, including Bill Gates, is not going to be able to go to college if it keeps going up like this.

Mr. DRAEGER. I think one of the concerns that is often overlooked in the whole college debt conversation as Jason pointed out, is the loan payments seem manageable for most graduates who graduate with an average of $25,000 in loan debt.

There is a whole another part of this which is the amount of debt that parents take on to send their students. So when you talk about those who are in their 40s, 50s, these are folks who are also probably parents who took on a substantial amount of loan debt.

One of the things that is missing in terms of safeguards, particularly on parent PLUS loans, is a simple assessment of their ability to repay the loan based on their current income.

So there is no, for example, debt to income ratio on parent PLUS loans. Again, we don't want to disrupt current enrollments, but for new borrowers or students down the road I think it makes sense to examine additional safeguards.

If the mortgage bubble taught us anything, it is that appropriate underwriting not only protects lenders, it also can protect borrowers.

Mr. ROE. Mr. Draeger, one of the things that happened too, I think, is the economy hasn't done well. It has encouraged students to stay in college longer and acquire more debt.

I thought for a minute, Mr. Draeger, you brought the health care bill with you when you have had that stack of papers out front of you when you first brought that here. I thank you for your testimony and I certainly appreciate the concern and I think we certainly can work on this.

I yield back.

Chairman KLINE. Thank the gentleman.

Mrs. McCarthy, you are recognized.

Mrs. MCCARTHY. Thank you, Mr. Chairman. I appreciate the hearing.

Dr. Mercer, I want to follow up with something that you have talked about in your testimony. You mentioned in your testimony that there have been a number of changes in the last decade to student aid that have occurred outside of reauthorization. Can you identify one or two of the changes that you believe has done the least amount to help stem costs of college for the average student?

Ms. MERCER. I am sorry, you said that has done the least to help stem the cost of——

Mrs. MCCARTHY. Right.

Ms. MERCER. I am—well I would say probably limiting the number of semesters that a student can actually use their Pell—they can have—receive Pell to go to college. If anything, that is a policy that was actually intended to help students expedite the time that it took for them to complete their degree, and thereby controlling

for costs both at the institutional level but more from the student perspective, for them to be able to move through the system.

So undoing that, in effect, leads to increased costs more so on the student perspective and it had no impact on the institution for them to change their policies in terms to helping advance students and move them through the system.

Mrs. MCCARTHY. One of the things I wanted to follow up on as we talk about these loans and it was just talked about as far as parents being able to carry that loan. We are talking about one student. What happens when there are two or three students in college? They might be stepped, but there is still three students.

I mean, you know, unless you are extremely wealthy, that is a little bit steep for a parent and certainly the goal is to have their children go to college if that is what they want to do. So I mean, technically, the parents are looking for everything they can, obviously the children are doing what they need to do, but I don't know whether anybody has actually really thought about that on what the loan is on for the parents.

I know things are better today. Grandparents can help technically. I guess that is what I am supposed to be doing, but I mean, when you think about it, it is mind boggling as far as that goes. Just to follow up on you, Mr. Draeger. When I hear everybody talking about also that these loans that are being taken out, Mr. Hinojosa and I, for years, we have been pushing financial literacy.

Now you said that the colleges can't give certain information to the student or to the parent. Would they be able to work it under the—a way of financial literacy to have them understand what they are actually getting into?

Mr. DRAEGER. So schools aren't prohibited from delivering information. The real problem is that we have a lot of information that we give them.

Mrs. MCCARTHY. Right.

Mr. DRAEGER. The issue is really that the school is prohibited from requiring any additional steps that is not mandated in legislation before a student gets their loans. So to require a student, for example, to build out a budget to say why is it if you are, for example, a part-time student borrowing at a full-time rate, let's walk through this and make sure that you understand why you need this money before we approve the loan.

Right now, schools aren't able to introduce or mandate those types of steps. So I think financial literacy is a huge part. In fact, many schools are partnering with former state-based agencies that operated in the Federal Family Education Loan Program that were part of the state or part of another nonprofit to try to develop and deliver more meaningful and engaging financial literacy to students, but again, unless it has teeth, I think we are always—it appears we are just delivering more information that they might not pay attention to.

Mrs. MCCARTHY. So let me ask you, why do you think the language is in there that the college can't give more information?

Mr. DRAEGER. I think at the time, when student loans were developed, this was viewed as entitlement aid and that the school should not come between a student and the total amount of financial aid that they are entitled to, and that includes loans.

But as demonstrated by this hearing and a lot of the things we see in the press, there is rising concern about the amount of family debt as you talked about the parents—the family debt that is being taken on and I think from the school perspective, we are questioning can we play a better and a more significant role with some teeth to be able to stop and ask students do you really need this much, this money in loan debt. Let's think through this together.

Mrs. MCCARTHY. Because one of the things I know—and this committee certainly worked on that—is educating especially new college students on when they went to register on all the credit cards that were available for them.

It was a big debate here because a lot of them were not prepared to pay those particular debts down. So it is complicated, but thank you.

I yield back.

Chairman KLINE. Thank you.

Mr. Walberg?

Mr. WALBERG. Thank you, Mr. Chairman. It is a bit surreal to be sitting here on a committee talking about student loan debts and trying to come to a solution when we are having a great deal of difficulty in dealing with $16.5 trillion debt that we have the with no real activity that we see in the pipeline to accept proposals that would reduce that debt and balance, but that is another point.

Right now in my home state of Michigan we are facing an unemployment rate of just below 9 percent, and though I represent Hillsdale College, that really doesn't find any involvement in our topic today. Yet I do represent some of the students from the some of world's greatest research universities like the University of Michigan, Michigan State, private religious-based institutions like Spring Arbor and Siena Heights University, Adrian Olivet Colleges, and community college systems in Lansing, Jackson, and Monroe that are models of academic and employer cooperation. I am pleased with that.

But right now, we are working with all hands on deck to keep our graduates in the state employed and primarily because of student debt and limited job opportunities.

The federal student loan program was created to help students pay for the high cost of tuition, but over the last 20 years, students in Michigan have seen their federal government gradually move to overtake all aspects of the student loans which has gotten us into a mess where we find ourselves now. It is my opinion.

We know that the student loan interest rates are not the sole issue facing Michigan students and other state students; however, as college tuition continues to skyrocket and students face staggering amounts of debt, we must enact comprehensive solutions that put our schools and our parents and our communities and next-generation on a path to prosperity.

So following in Mrs. Foxx's questioning, just briefly, I ask of all of you, if any of you know of any state or any—excuse me—any study showing the relation between the ever increasing higher education costs and the lack of any real present disincentive to student debt. Any studies that show any comparison, any relation of high cost of education versus the student debt?

Mr. DRAEGER. I would be happy to submit some of these studies to the record. The ones that we have looked at have shown that that even in periods where financial aid wasn't increased, grants or you kept the annual and aggregate loan limits steady college costs have continued to go up and so the function between financial aid and debt which is a function of cost just doesn't seem to correlate.

We haven't seen that corollary function. So I would be happy to submit that, those studies, for the record.

Mr. WALBERG. Well, I would appreciate that.

Mr. DELISLE. I mean this is a pretty difficult thing to pin down but I think that there is a couple things we should keep into context. You know, an undergraduate, a dependent undergraduate in their freshman year can borrow $5,500 through the federal student loan program.

It is hard to imagine that that amount of subsidized credit really moves the needle on tuition, but now if you look at graduate programs where the student can borrow up to the full cost of attendance as set by the institution for as many years as they want to, you can get two, three, four, five graduate degrees and just keep borrowing and pay for your cost-of-living while you are there.

My guess is if there is a place where loose and very cheaply available federal credit is pushing up the price of college education, it is definitely in the graduate programs.

Mr. WALBERG. I appreciate that. That is probably an area we ought to look to find disincentives to encourage our costs of education to moderate at some point and that probably ought to be part of our quest.

I also would guess that providing further incentives to families to save for college education would be helpful in the process.

Mr. Draeger, about how many students are benefiting from the subsidized Stafford loans currently being offered a 3.4 percent rate?

Mr. DRAEGER. By our estimates, looking at NPSAS data, about 7.5 million.

Mr. WALBERG. How many of these students also obtained subsidized loans with PLUS and Stafford?

Mr. DRAEGER. Just about half of them. So 4 million of our subsidized borrowers are also borrowing in the unsubsidized Stafford loan program.

Mr. WALBERG. Are there any private lenders able to offer loans to Michigan or other state students at significantly lower rates?

Mr. DRAEGER. We have seen private lenders who are currently marketing rates lower than the federal loan limit—or excuse me, federal interest rates, particularly for Stafford and PLUS.

The unknown question, the answer that I can't give you, is what the distribution is; how many people who apply for those private loans are actually getting them.

What makes it difficult for financial aid administrators is trying to explain the benefits of staying in the safety of the federal loan programs when private loans are being marketed at a lower rate.

Mr. WALBERG. Thank you.

Chairman KLINE. The gentleman's time has expired.

Mr. Tierney?

Mr. TIERNEY. Thank you, Mr. Chairman, and thank you for having this hearing, Mr. Chairman. I think it is good to begin the discussion and certainly we have to address the doubling of the subsidized Stafford loan, but we have to go on beyond there. Obviously we can't stop there. We have to think a little bigger. We have to look at the responsibility over the whole realm of that.

But I wanted to try to put this conversation in a little context. Most of my constituents think it incredibly unfair that Wall Street banks can go to the Federal Reserve and borrow money at almost no interest rate at all, yet they turned around and look what they have tomorrow to go to college and they find that comparatively exorbitant compared to that.

Now, the people on Wall Street are the ones that just about wrecked our financial system taking these reckless risks and yet they can go it get a deal. All that the people who are trying to do when they graduate is added to the nation's productivity, innovation, and creativity, but they get a bad deal in comparison on that.

So that is the context in which I work. A lot of people coming into my office and wanted to know what the heck is going on.

Dr. Lucas, you mentioned that one of the reasons—and correct me if I got this wrong—but one of the reasons why interest rates should increase and not be fixed is that lenders need to be assured their return on capital will increase to account for that inflation. Is that fair?

Ms. LUCAS. I said that if inflation were higher that is what the market would require.

Mr. TIERNEY. It would. All right, and you are saying if that doesn't happen that it is a cost to the taxpayer.

Ms. LUCAS. I am saying that when you fix loans as they are now when inflation goes up you are still charging students the same rates, which makes the loans further below market rates.

Mr. TIERNEY. Below market rates on that. But what if the lender was a not-for-profit? What if the lender was somebody that said, you know, I am happy to cover my costs? And I think that there is a value to covering my costs and not getting that profit back or on that basis because I think it is good public policy to have more people graduate from school, increase our productivity, our creativity, and all of that going forward, then that is a whole different consideration, right?

Ms. LUCAS. I agree with you completely that it may be good public policy to keep the interest rates on student loans low. My comments about changing the accounting for them had to do with the transparency and recognition of the true costs which would make it easier for Congress to decide to use student loans in judicious proportion to other types of aid, but as far as——

Mr. TIERNEY. So we would get to see—so we would get to see what our public policy was is what you are saying. You get transparency and you know what profit you weren't making and be able to decide whether or not that was commensurate with the policy plusses that you thought you might get. So they can make that kind of decision on that basis.

And I think that is great, but—and I think that is the kind of discussion we ought to have around here but I don't think we ought to lose sight that it is—you know, we are not a for-profit organiza-

tion and we talk all the time about—our rhetoric speaks to the idea of needing more college graduates and all of our employers need it and we need it for our productivity and for our creativity and our innovation, but our policies and our interest rates still counter to that.

You know, making it difficult for people to pay off loans. Some people don't even go to college because they see the frightening costs going forward. So I think we ought to have that discussion but not lose sight of the fact that there is a value to not making a profit so much.

And if we thought we had to make up that money somehow, maybe we wouldn't give billions of dollars in tax subsidies to oil companies every year. So basically shoveling money out the door to them as a gift with no real public policy plus back on the other side, or if we thought we had to make it up, maybe we would put a transaction tax on those very Wall Street people that almost drove us into ruin and slow down the volatility of the electronic trades and at the same time for the value of what the proposal I have seen is the cost of about 1 cup of coffee, one dollar for every 800 cups of coffee and we get a plus on the way the market runs and also get them to start contributing to fixing what is going on in the country and get us more graduates on that.

That is all I really wanted to cover on that, but I do think on the other part of that, Mr. Chairman, is that at some point we have to start looking at making sure that the people that have these college loans and they are getting collections on the other end get treated the same as people that have borrowed for other purposes.

I mean, Donald Trump can walk into bankruptcy, clear his record, and go out and start investing the next day, but a student that falls on some calamity and can't repay their loans cannot go into bankruptcy at all and never gets a restart. I have a number of people that come into my office that just keep having trouble with the collection process, penalties, interest going up and up on them and they seem to never be able to get out.

So I think we need some consumer protections. We need to take a look at why students are one of the very few groups that can't get the protection of bankruptcy that our Constitution generally affords everybody else, and then we will have truly looked at this on a larger scale on that basis.

So I thank you, and I yield back.

Chairman KLINE. Thank the gentleman.

Mrs. Roby?

Mrs. ROBY. Thank you, Mr. Chairman. I would like to thank all of the witnesses for being here today and just want to talk about—last district work week I organized a roundtable discussion with Alabama's Department of Postsecondary Education Chancellor, Mark Heinrich, and presidents of Alabama's community colleges in my district.

And we had a great discussion about the impact that federal policies and regulations have on their colleges in addition to college affordability and as you can all agree, here in the United States we are fortunate to have a diverse educational system.

Students can use federal financial aid and many other scholarships and funding sources to attend their school of choice; public,

private, proprietary, 2-year, 4-year, certificate, undergraduate, graduate, et cetera.

And for these student loan programs to remain available, we have got to strengthen them. So I just have a couple of questions.

Mr. Delisle, historically the interest rate for PLUS loans are often a little bit higher than the rates of the Stafford loans. So my question is do you believe that the higher PLUS loan interest rates deters graduate students or parents from borrowing and obtaining a postsecondary education?

Mr. DELISLE. Well, I do think on the parent side, I think there something that you might want to be concerned with which is there is a little bit of an adverse selection issue where the interest rate on a parent's PLUS loan, the APR, is 9 percent.

I know we talk about the 7.9 percent, but the APR is really 9 percent once you add in the 4 percent origination fee. Department of Education, by the way, I think is the only financial institution that can tell you what the interest rate is on your loan without telling you what the APR is.

So the APR is 9 percent. So parents, the people who think that is a bad deal can go somewhere else and borrow—they can get a home equity loan or they can use savings or they could borrow in the private market and get a variable rate.

People who are stuck paying the high rate are people who can't find any other means of credit, people who are those that are probably most likely to find that repaying a loan at 9 percent APR is difficult.

Then on the back end, if you look at graduate students who borrow those loans, they will get out of school, say they find a job and they find a high-paying job; who is going to pay back the loan first? The person who is making the money that can pay back that Grad PLUS loan or refinance it in the private market frankly. There are companies out there that are doing that.

So what is left in the loan pool? It is people who can't pay quickly. You have essentially on the front end you have selected out the good risk and then on the back end you are further selecting out the good risk and you are left with a pool that is most risky.

Combine that with the generally, you know, I think, mischaracterization that the program makes money for the federal government when you have those kinds of dynamics going on, I think it is unusual. So this is one of the problems with the interest rates in the PLUS program.

Mrs. ROBY. Okay. Thank you.

And Dr. Lucas, what factors do banks consider when they look to originate student loans versus the factors that the federal government takes into account?

Ms. LUCAS. Yes, well the federal government treats student loans as an entitlement, so they basically don't take into account any financial factors of the student but rather the costs of attendance.

A private lender would look at credit history, credit ratings, whether income is sufficient to afford the repayments, wealth, and so forth. So it is quite different.

Now student loans are valuable just because they don't look at those things. The justification for student loans is a student might have no credit history, no credit score, so the government is step-

ping in and providing credit where it might not be available in the private sector, and the government is purposely doing it at a rate that isn't attainable in the private sector because that is what students need to have the opportunity to pursue an education.

So there is certainly a justification for the way the government has structured the program. Just to repeat, I feel that those kinds of subsidies are completely appropriate and they are the role of the government and credit markets. It is problematic when you make these below-market loans and you claim that not only have you helped the students but you have created profits that the government can spend elsewhere.

Mrs. ROBY. Thank you.

My time is running out. I have one more question for Mr. Draeger, but I am going to submit it to the record for an answer.

So thank you, Mr. Chairman. I yield back.

Chairman KLINE. Thank the gentlelady.

Mr. Holt?

Mr. HOLT. Thank you, Mr. Chairman.

I think the witnesses.

You know, there are lots of details that I would like to get to about whether low income borrowers are more likely to be harmed by being locked into a higher interest rate if we have variable interest rates. There is a lot to be said about—or a lot to be discussed about income-based repayment, but I have got to get to the basic question here that has not been cleared up this morning.

And that has to do with—let me ask you to get that for me there again—whether this actually costs taxpayers or not, and if it does, whether this is something that we want; whether this is a public good that we are requiring here.

The CBO issued a paper this year that says CBO estimates that new loans and loan guarantees issued in 2013 in the amount of $635 billion would generate budgetary savings of $45 billion over their lifetime, thereby reducing the budget deficit.

However, using a fair value approach, which we have heard discussed this morning, CBO estimates that those loans and guarantees would have a lifetime cost of $11 billion, thereby adding to the deficit.

Now the witnesses here seem to be, at least Mr. Delisle in particular, seem to be offended that the federal government might consider offering risky loans at better rates more favorable than the market, then the private sector would offer.

In fact, Mr. Delisle, you said it was ridiculous to look backward to see whether we might recover—the taxpayer might recover money. It seems offensive that the government might be pursuing an interest that the private lenders were not willing to pursue.

That is why we are here. We are trying to look after the public good, not just the return on investment for a particular bank, and therefore we don't need to match what they do.

We may be better, as Mr. Tierney has said and others, we may be better off as a nation to have more people educated in college and educated in graduate school and so it is interesting—you use the phrase "moral hazard."

Now, you know, for oil companies or financial businesses who are encouraged to shift more and more risk to other people while they

make out like bandits—and I use that term advisedly—that is a moral hazard—that is not a moral hazard, but for students to shift some of the risk to society at large is a moral hazard, where you seem to be putting an emphasis on the word moral as if the shame here is that we are creating a generation of scofflaws.

No, what we are trying to do is create a generation of innovators, a generation of doers and makers, a generation of educated people, and until we face that point and get that question out from under this, it doesn't make sense to talk about whether we want variable loan repayments or income-based loan repayments.

And I think we are just talking past each other here this morning. I realize—I don't know how to put this into a question, but I just was so frustrated to hear this, this morning. Did you really mean, Mr. Delisle that it was ridiculous to look historically whether the taxpayer gets the money back and not at the rate that a bank would have gotten it back?

Mr. DELISLE. I think it is ridiculous to value risk when you know what happened. That was my point of view. There is no way, if you were going to make a bet on a coin toss and then place your bet after you knew the results, there is no more risk in the transaction. That is essentially the issue, but I did say that I do support——

Mr. HOLT. With all respect, you make a bet on a coin toss after you have seen that coin tossed 1,000 times and you know how biased it is, then you make your bet.

Mr. DELISLE. And there is still some chance going forward.

Chairman KLINE. The gentleman's time has expired.

Dr. Heck?

Mr. HECK. Thank you, Mr. Chairman.

Again, thanks all of you for being here and I approach this debate from somebody who is still paying off their student loans. I don't know how Dr. Roe did it, but I am still in repayment and from somebody whose daughter just began her student loan repayments, so I see it from both sides.

Mr. Delisle, you suggested that a fixed rate at some index plus a percentage, I think you said 3 percent at the time of issue, that would remain constant and I am assuming that is even into the repayment period, so that is fixed. And I think that potentially has some merit because I get periodic notices of my student loan payment changing by plus or minus $5, but there is always a question as to what the rate is going to be.

But as was mentioned by Dr. Lucas, if loans are disbursed by semester, theoretically you could have a situation where you might have eight or more student loan rates depending on how long it takes you to complete your education. Is there a downside to the fact that you are going to have eight or more separate loans at different interest rates during the course of your academic career and then into repayment?

Mr. DELISLE. That is true. That is what would happen. Under the proposal that we have discussed though, the rate would only readjust once a year. So wouldn't happen in the middle of the course of your school year, but theoretically, yes, you could have multiple loans.

Now you can consolidate and them so that you get one weighted average interest rate on the loan. But that is a downside that peo-

ple will have different rates, but there is really no way around that. You can't give people fixed rates that are based on something that are then always the same. They are mutually exclusive qualifications on what you are trying to do.

Mr. HECK. And at risk of bringing up the term "moral hazard" again, but I believe that you mentioned moral hazard in a context of a system that is actually encouraging people to borrow more money than they need to borrow and if that is the case, would you believe that there is also a moral hazard in the loan forgiveness at 10 or 20 years and that the fact that we are having people sign a contract or a promissory note with the idea that after 10 or 20 years they may not be liable for the amount that they signed for on the bottom line? Is that not another potential moral hazard?

Mr. DELISLE. Yes, and that is what the moral hazard is and the moral hazard is not in the undergraduate programs because we subject borrowers to a strict loan limit. They can't borrow an unlimited amount of money, so on the front end—you have either—you have capped it—essentially how much they can borrow on the front end.

And if there are, you know, sort of well-founded public policy rationales for having an undergraduate loan program and Dr. Lucas mentioned them which is that these are people who you won't get a fully functioning credit market.

So I you know, I reject a little bit the way that Congressman Holt characterized my earlier testimony in that I fully support a federal student loan program and one that makes subsidized credit available to all students, but the issue is on loan forgiveness and the Grad PLUS program where you can borrow an unlimited amount of money and not have to pay it all back any longer than 20 years and then it is forgiven.

That is where the moral hazard is and we have run the numbers with a calculator that we developed at the New America Foundation that is publicly available, and we have run literally thousands of income scenarios and borrower debt scenarios through this, and word will get out. This is a newly available program but people will soon figure out that there is really no difference in repayment between borrowing $100,000 or $150,000. There is really no difference. So what would you do?

Mr. HECK. Mr. Draeger, you mentioned earlier that you referred to the safety of staying within the federal student loan system versus going outside to private loans. Can you explain what safeties there are within the federal student loan system that are not out with the private-sector loans?

Mr. DRAEGER. Essentially, the federal loan programs provide safeguards and checks available for students and parents to ensure that if their loan payment is ever more than their income that they can remain within an income-based repayment currently.

There is loan forgiveness so that people who enter aren't deterred from entering public service or other nonprofit service where they are not going to have a large income. There are protections against death and disability so that your loan debt isn't passed on to others in your family or doesn't persist after you are permanently disabled.

So those are the protections that are available to students. It is difficult to point those out to them when they are seeing advertised rates that just aren't aligning up with the federal interest rates.

Mr. HECK. And then if you could, just very briefly in the time remaining, as the representative of more than 17,000 financial aid administrators, what singular change to the federal financial aid system should be this committee's priority to strengthen the federal student loan program?

Mr. DRAEGER. We think going back to something that was mentioned earlier, we would love to see a comprehensive discussion on reauthorization of the Higher Education Act because it is difficult to make an adjustment to one program and not expect unintended consequences in another. So the piecemeal approach that has been taking place through budget is less desirable than taking these as a whole.

Mr. HECK. Thanks, and I am hopeful that we will reauthorize it before its 2014 expiration date.

Thank you, Mr. Chair. I yield back.

Chairman KLINE. Thank the gentleman.

Mr. Courtney?

Mr. COURTNEY. Thank you, Mr. Chairman, for holding this hearing.

And again, I want to thank Mr. Delisle actually for your testimony which sort of walks through the history of Stafford student loan and again, I think, you know, in response a little bit to the Chairman's opening comments, the box we are in right now in terms of fixed rate Stafford loans was created in 2002, and I realize that there is frustration about the fact that the cut to 3.4 percent in 2007 was kind of a piecemeal solution, but the fact is, is it was an attempt to try to ameliorate the fact that 6.8 by the time 2007 rolled around was out of sync with the market which a number of the members have pointed out and certainly that was the case last year.

I think frankly that was the power of the President's message when he was on the road which is that people were seeing home mortgage rates at 3 percent and kids were going to see their rates go up to 6.8 percent. Hopefully we can find that sweet spot to try and adjust the system.

But again, it is a challenge because of that 2002 budget baseline that everything costs money when you are trying to sort of fix this thing and—but I think again, we have got to sort of step back and recognize there is a social value here about making higher education affordable.

I was with the Connecticut Department of Labor last week. We have about an 8 percent unemployment rate in our state, but for people with 4-year degrees it is 4 percent. People who have a high school degree it is 12 percent and that shows why, you know, we, all of us as Americans have skin in the game in terms of trying to come up with a system that again tries to create opportunity because we all benefit from it and it is a social benefit that we shouldn't allow arbitrary budget rules to necessarily interfere with. We should try and sort of get it right.

Mr. Delisle, your sort of concern about graduate education being sort of too—lacking in skin in the game for students; I am just try-

ing to just sort of understand—we had a hearing a couple days ago in the wake of Newtown where we had school-based mental health testimony about the fact that there is a crisis right now in terms of finding pediatric psychiatrists and adolescent psychiatrists.

I mean, the cost of medical education, which is certainly part of that graduate school tier that you are focused on is too high for a lot of critical professions like pediatric psychiatry to be affordable.

So if we have a policy for loan forgiveness that again is trying to address critical workforce needs in this country, which again, the mental health system we all know in the wake of December 14, is desperate for help.

I mean, do you include those types of initiatives in terms of criticizing loan forgiveness?

Mr. DELISLE. Well, what we suggested is that the timing of the loan forgiveness be somehow linked to the amount that you borrowed. So if you borrow more, that the loan forgiveness would happen after 25 years of payments rather than 20.

We haven't made any sort of statement on the loan forgiveness provision for nonprofit government and religious employees at 10 years of payments. Obviously, the graduate students are going to benefit quite a bit from that because they are going to have the most debt, but, I mean, I see that as a slightly separate issue since that is a program that essentially is providing a subsidy in one way or another to people who are working in jobs that Congress believes are valuable.

I do think, however, though, that it is a very, very un-transparent way to provide a subsidy to those people. I am not even sure that they know they are getting it.

Mr. COURTNEY. So for a medical student right now who maybe would aspire to going into a specialty area that frankly does not compensate as well as being an orthopedic surgeon or whatever, you know, we have, I think, a duty to make sure that we are helping people make that choice and loan forgiveness when you are talking—I mean, medical students are coming out with $200,000 or $300,000 in debt.

And if you are saying well be a, you know, pediatric psychiatrist where you are going to be basically you know living you know a pretty meager existence, that is just not an option for people—and I—so where does that fit in to your sort of critique?

Mr. DELISLE. Well, I mean, I would say right now under current policy, it is not an issue. I mean, and you have made recommendations to changing current policies——

Mr. COURTNEY. Actually, the Affordable Care Act has a loan forgiveness program for adolescent psychiatry and pediatric psychiatry which expires this year.

Mr. DELISLE. Well, the student loan program though is permanently authorized, loan forgiveness for public service, nonprofit——

Mr. COURTNEY. Wait a minute.

Mr. DELISLE [continuing]. It is permanently authorized.

Mr. COURTNEY. But a pediatric psychiatrist is not a nonprofit——

Mr. DELISLE. Oh, if they are not—oh, so if they are working in a for-profit, then they get loan forgiveness after 20 years.

Mr. COURTNEY. I mean, that is the way the professions are structured.

Mr. DELISLE. And then they—so if it is in a for-profit, that they get loan forgiveness after only 20 years' payments——

Mr. COURTNEY. Well, I——

Mr. DELISLE [continuing]. Regardless of their income.

Mr. COURTNEY. I just think, you know, that is a blind way to——

Chairman KLINE. The gentleman's time has expired.

Dr. DesJarlais?

Mr. DESJARLAIS. Thank you, Mr. Chairman.

There are so many things about this issue that are troubling to me and I feel like we have just been kind of missing the point as we talk about what the federal government should do, what the interest rates should be, and that is just the personal responsibility of the students.

I, like my colleague Dr. Roe, am a little more seasoned, maybe not quite so much as him, but I graduated medical school in 1991 with $120,000 in debt. My lowest interest on my loan was 9 percent. My highest was 18 percent. And I couldn't have gone to college and medical school without Pell grants and loans so I am very much in favor of the programs, but they have to be managed properly.

You know, this ship is sinking because of mismanagement and educational institutions continue to raise costs because we continue to throw money at that.

Pell grants just 6 years ago helped 5 million students at the cost of $12 billion. Now we are helping 9 million students at the cost of $43 billion. So that ratio isn't working. We are subsidizing student loans. Student loans have almost become an entitlement and as Mr. Draeger said, I don't think we are educating students and Mr. Delisle also. There is no disincentive for kids to be responsible.

It is very easy for us to be cavalier up here when we talk about federal government or federal loans, but all you out there are taxpayers, and the federal government is made up of taxpayers. There aren't federal loans; there are taxpayer loans. We are paying these loans and we should be able to get a return on investment.

If you educate a student and they get a good job, then they should be able to come back, pay off these loans, become a taxpayer, and this should all work out, but it is not working out because we are not looking at the real problem.

When a lot of us went to college, you went to sign up and it was a 4-year plan. You were going to graduate in 4 years. You took 16 credit hours. I have got a senior graduating right now that is looking at his colleges, almost every one of them starts at a 12-credit hour program. There is no way to finish in 4 years.

So are we creating lazy kids? Have we gotten to the point that we want so much for our future generations to have it better than we did that we have handicapped ourselves and we have done that through spending?

You look at the federal government debt, and it is at almost $17 trillion and it is rising. These student loan debts now surpass—I think as Dr. Roe said, auto loan and credit card debt combined in this country, and we are making it a situation where they don't have to pay these back in a reasonable fashion.

When I got out of medical school with 18 percent interest loans, I didn't want to go buy a new house and car, I wanted to get those loans paid off and did so in 7 years because I was so privileged, in my mind, to get those loans and have the ability to go to college and go to medical school, but now I don't think kids have that same level of education and we are failing at a bunch of levels.

The institutions are failing by looking at the money they can make with prolonged student participation and the graduation rates are abysmal. I mean, I think that right now in a 4-year institution, if you go back to the 2004 class, only 38 percent are graduating 4 years, 53 percent at 5 years, and 58 percent at 6 years.

So your taxpayer dollars are not being invested wisely and the problem I think is in the education of the students, the responsibility of the educational institutions, and then the good proper parenting of the federal government to use the money wisely.

If you all were private lenders right now, were going to take over this program, you would look at it like we are all looking at it today. You would look at it cannot lose money and I think that that is what we need to be focusing on to fix this problem.

So, Mr. Draeger—someone brought up earlier work-study too. I did work-study and that was great. What if we shifted some of this Pell Grant money into work-study and people actually learned responsibility and worked?

When you go to college, you are poor; I mean, you are poor in college and not just, I mean, that is actually part of the fun of it. If you are not poor, then you have money and the student loans shouldn't be an issue anyway.

So, you know, we have got to be realistic in what we expect. We have kind of created this false sense of prosperity in our country here today with the federal government and that is why we have this debt problem.

So is there a way that we can start to push for a 4-year program again, more responsibility, and is there a way to shift study funds? Mr. Draeger and Mr. Delisle, you both had great comments. I will give you just a few seconds to chime in on all that philosophy.

Mr. DRAEGER. So to answer the question about can we do more particularly with financial aid to push students through college at a faster rate, one of the things that was rescinded fairly recently without a lot of study was year-round Pell grants; the ability for students to attend all the time throughout the year as opposed to a traditional academic year.

And there were concerns about the cost of the program, there were concerns about misestimates on how many students would utilize it, but that was a good example of how we can make financial aid more agile to meet the needs of modern students, which is allow them to enroll ongoing so they can get through their program at a lower cost and become productive members of society.

Mr. DELISLE. Well, one of the things that we proposed in a paper that we recently released at The New America Foundation is that you time limit loan eligibility. Right now, loan eligibility is just an aggregate and annual number mostly pulled out of thin air. So you could borrow essentially for 7 years to complete a 2-year degree.

And that is an area where you might want to align the amount you can borrow or for how long you can borrow with the types of programs you are pursuing.

Chairman KLINE. The gentleman's time has expired.

Ms. Bonamici?

Ms. BONAMICI. Thank you very much, Chairman Kline and Ranking Member Miller, for holding this important hearing today.

I have a group of students visiting today from the great city of Hillsboro, Oregon, they are with the Mayor's Youth Advisory Council, and I assure you they are very interested in this topic, so thank you.

Before I ask my question, we have a letter here from Robert Reischauer, the former director of the CBO, stating opposition to the fair value accounting, and I would like to make sure that that is entered into the official record.

[The information follows:]

ROBERT D. REISCHAUER,
5509 MOHICAN ROAD,
Bethesda, MD 20816, January 23, 2012.

Hon. CHRIS VAN HOLLEN,
1707 Longworth HOB, Washington, DC 20515.

DEAR REPRESENTATIVE VAN HOLLEN: I am writing in response to your request for my views on the desirability of adopting "fair value accounting" of federal direct loan and loan guarantee costs in the budget as proposed in H.R. 3581. I strongly oppose such a change.

The accounting convention used since enactment of the Credit Reform Act of 1990 already reflects the risk that borrowers will default on their loans or loan guarantees. Under Credit Reform, costs already are based on the expected actual cash flows from the direct loans and guarantees (with an adjustment to account for the timing of the cash flows). H.R. 3581 proposes to place an additional budgetary cost on top of the actual cash flows. This additional cost is supposed to reflect a cost to society that stems from the fact that, even if the cash flows turn out to be exactly as estimated, the possibility that the credit programs would cost more (or less) than estimated imposes a cost on a risk-averse public. Under the proposal, this extra cost would be the difference between the currently estimated cost of direct loans and loan guarantees to the federal government and the cost of those loans and loan guarantees if the private market were providing them.

A society's aversion to risk may be an appropriate factor for policymakers to take into account in a cost-benefit assessment of any spending or tax proposal but adding a cost to the budget does not make sense. Nor is clear that the cost of societal risk aversion should be based on individual or institutional risk which is what the private market reflects. Inclusion of a risk aversion cost for credit programs would be inconsistent with the treatment of other programs in the budget (many of which have costs that are at least as uncertain as the costs of credit programs—for instance, many agriculture programs and Medicare) and would add a cost element from a traditional cost-benefit analysis without adding anything based on the corresponding benefit side of such an analysis. It would also make budget accounting less straightforward and transparent.

H.R. 3581 represents a misguided attempt to mold budget accounting to facilitate a cost-benefit analysis, with the result that neither the budget nor the cost-benefit analysis would serve their intended purposes well.

I would be glad to discuss these issues in more detail if you would like. With best wishes.

ROBERT D. REISCHAUER.

Chairman KLINE. Without objection.

Ms. BONAMICI. Thank you, Mr. Chairman.

I appreciate the discussion that we have had about financial literacy and making sure that students and their families understand what they are undertaking when paying for a college education.

And Mr. Draeger you talked about disclosure and you have your big, big binder with disclosures in front of you.

But we have also talked about what has happened in the financial markets and drawing some analogies there, certainly with mortgage brokers having more of a fiduciary responsibility to make sure that their customers or clients get the best deal possible. I think we need to have a discussion about making sure that students really understand what is the best package before them and it is my understanding that at the height of the private loan market in 2007 and 2008 about half of the undergraduate private loan borrowers still had capacity to take out additional federal loans.

So I wonder how we could better ensure that students understand the differences between private and federal loans and ensure that they are really made aware if there are federal loans that are available to them, that they have that information, that they really exhausted all of the federal options.

And Mr. Draeger, if you would like to take that, please.

Mr. DRAEGER. Be happy to. I think you will find widespread agreement amongst institutions, student advocates, students, and even loan providers that the best way to do that is to require school certification on private education loans.

That no private education loan should be made without the knowledge and the certification of a financial aid office; that the student is indeed enrolled, and if they are considering a private loan that they fully understand the terms and conditions and disparities between the private education loan and the federal loans.

Ms. BONAMICI. And how much more work is there to do probably some institutions are already doing that but not all.

Mr. DRAEGER. The work would be minimal because they are already doing this on all federal loans. So it is basically a duplication of a process that they have already mastered and one that I think most private education lenders, reputable ones, would welcome as well because they want to make sure those students are in fact enrolled for the period of time that they are taking the loan for.

Ms. BONAMICI. Thank you so much.

I wanted to turn to Dr. Mercer. I appreciate your attention to the issue of access and completion because completion is an important part of getting through our investment, and our taxpayers' investment in education.

I had to Oregonians visit my office yesterday and they both went through school with the support of Trio programs and they talked about how TRIO had changed their lives and really played a critical role in making sure that they ultimately succeeded.

So access was crucial, but they wouldn't be here today without the support of the programs that break down the barriers and help them continue and complete their studies.

So Dr. Mercer, what are the biggest barriers to completion that college students face? And what role do loans play in the challenges to degree completion? And if you could distinguish between private loans and federal loans in talking about that. Thank you.

Ms. MERCER. Thank you. I think as one of the panelists indicated before, most students generally report that cost of going to school as the biggest challenge that they tend to experience and our con-

versation today has largely focused exclusively on obviously the acquisition of loans and the impact that that has.

What we haven't really touched upon obviously is the role of grant aid and how that makes a difference as well as how you can incorporate an appropriate amount of work into a student's schedule to ensure because there is research that substantiates that an appropriate amount of work actually does encourage students to move through and complete degree.

The pivotal part and as you mentioned, TRIO, is the lack of the institution's role in terms of not just counseling because that is obviously is a part, but supporting students to move through the system. By definition, most of the individuals who are receiving this aid have need. Often times they come with other indicators of risk such as probably low preparation or being married, having children, things that make it more difficult for them to move through the system and not less.

So failing to provide them with support outside of just counseling and understanding the amount of loans one is borrowing is really a critical piece of that. And that is one of the parts in the report that the alliance recently released talking about student aid, is that it needs to be comprehensive and there needs to be appropriate amount of institutional supports built in to make sure that students are able to move through the system.

With respect to loans, I would say loan volume obviously and keeping that appropriately managed for students as they move through the system is critical whether that be private or the federally supported program. I am not sure the distinction really exists except for the fact that there are many safeguards built into the federal program that don't exist in the private market.

Ms. BONAMICI. Thank you.

Chairman KLINE. The gentlelady's time has expired.

Mr. Grijalva?

Mr. GRIJALVA. Thank you, Mr. Chairman. I appreciate the hearing. I appreciate the time.

I am still trying to get my head around some concepts that I heard today. That irrespective of the amount of money you borrow or the interest rate that you still ended up paying the same amount. I am going to have to work on that one a little bit.

And also what a horrible and ridiculous idea that students might get a better deal from a government administered loan as opposed to a private sector loan. Those two concepts are things that I am still having trouble understanding fully; or why there is opposition.

Mr. Draeger, you recommended I think that colleges be—you are recommending that colleges be given greater authority, to limit students eligibility for loans, and the monitoring of those loans; however, your organization's recent RAD white paper said, and I quote—"Restrictions on federal loan borrowing could drive students to borrow under less advantageous private loan programs, discourage some students from enrolling, or cause more enrolled students to drop out due to lack of funds."

Given that statement in your white paper, what evidence can you point to that would outweigh the risks of forcing all of those three bad consequences and the statement about the limitation that you have been talking about.

Mr. DRAEGER. I appreciate you bringing up our "Reimagining Aid Delivery and Design" paper where we put forth ideas that——

Mr. GRIJALVA. I know, answer that part of the question.

Mr. DRAEGER. Well, my answer is that we recognize the limitations of our own proposals. If you had a requirement for private student loan certification, then all of that would be running through the financial aid office and you could mitigate the risk of students going into the private market without the knowledge of——

Mr. GRIJALVA. And in that report, if I may, sir—and in that report you also I am sure have provided data documenting the over borrowing problem that has been mentioned here today, that the committee would—that you could share with the committee. Do you have that data?

Mr. DRAEGER. Sure. We can submit that.

Mr. GRIJALVA. Okay. That would be great.

I also—one kind of general question, you talked about the 13 percent default and the focus being on the graduate student, let me, for anyone that wants to respond, in that 13 percent default on loans, are you making a distinction between for-profit colleges and not-for-profit colleges and public colleges and institutions of higher learning and community colleges?

Is there a distinction being made and is the gravity of the default higher in one area than in another? And if so, what restrictions or strategies in terms of student loans would you recommend to this committee in order to bring let's say—let me guess that the for-profit college has a higher default rate—how would you bring those——

Let me begin with Dr. Mercer, if she has a comment.

Ms. MERCER. I am sorry, from what my limited research on, in this area, is that default rates do generally tend to be higher at for-profit institutions. Often times, you have to look at the reasons why students are defaulting on their loans.

Obviously, a lot of it is simply that students don't have money whether they are aware or knowing that they should——

Mr. GRIJALVA. If I may, doctor. I think a part of it is that the point that the revenue source is part of the profit line. And so recruitment strategies and obligating students to a certain amount of loans does increase the likelihood, and as all the witnesses said, you know, pre-counseling, post counseling in terms of loan acquisition is very important points that have come up in this hearing, but when the bottom line is at stake here, does that ethic follow as closely as it should be?

Ms. MERCER. Right. There probably needs to be much greater attention paid to how these students are being selected and moving through the system and the aid that they are receiving.

I think you also have to consider the quality of degrees that students are receiving, or if they are receiving degrees at any institution, to ensure that the amount of loan that they have assumed positions them once they complete, if they complete, to be in a position to be able to repay.

Mr. GRIJALVA. I don't know how much time I have. I don't think I have much time.

Thank you, Mr. Chairman. I yield back.

Chairman KLINE. Thank the gentleman.

Mr. Polis?

Mr. POLIS. Thank you. Am I the last speaker, Mr. Chair?

Chairman KLINE. You are the cleanup batter, sir.

Mr. POLIS. Excellent. It is a long-standing tradition of this committee to save the best for last. So I am very exalted to be in this position.

My first question is about online education. My district is the home to the global program of Colorado State University, University of Colorado also has an online programs; students across the country.

One concern I have is that federal loan programs are still oriented towards the bricks and mortar model with regard to cost of living and other requirements which aren't really applicable for online universities.

How do we make sure that federal loans for online courses are treated the same as loans for traditional classes and don't deal with them in a discriminatory way just because some of their cost factors are different? I will open it up to whoever wants to comment on it.

Mr. Draeger?

Mr. DRAEGER. Can I ask one clarifying question? Do you mean discriminated in terms of limiting them, making them smaller even though they still have educational expenses?

Mr. POLIS. Exactly. Currently, a component of the loans are designated for cost-of-living which is not necessarily an appropriate restriction for online; however, they have other expenses that are not appropriate for the off-line.

Mr. DRAEGER. Right. So I think there is an idea that if you are taking an online course that doesn't require as much time, and so therefore you must be working a full-time job and therefore don't need living expenses built into your cost of attendance.

The truth of the matter is, a rigorous online course is going to require the same amount of time that a blended or brick-and-mortar course would. So I think it is important that we continue to examine online courses in the context of these folks may not be doing a full-time job and a full online course and be able to do those things simultaneously just like brick-and-mortar.

Mr. POLIS. So would you recommend considering either making the definition of some of the cost of living requirements more general or simply having less restrictions on it to ensure it doesn't discriminate against innovative curriculum delivery methods?

Mr. DRAEGER. My sense is that that is—some of those decisions are best left at the institution, which is why we are asking for broader authority to be able to adjust some of those—the limits of borrowing based on academic program or enrollment so that schools can take a look at their student populations and adjust accordingly.

Mr. POLIS. And the next question is for Mr. Delisle. To avoid accountability and oversight, I have heard of several examples where colleges might be masking high default rates by grouping campuses for purposes of reporting that a high rate at one campus might be masked by a low rate at another. What should be done to prevent

colleges from using this kind of tactic to evade responsibility and prevent transparency around student debt?

Mr. DELISLE. Well, we actually prefer repayment rate to default rate for——

Mr. POLIS. Whatever term you use.

Mr. DELISLE [continuing]. Assessing because it is going to show you even though people who don't default, but graduate with a high debt to income ratio or are struggling to repay their loans in that their loan balance is growing and not shrinking, which is something we allow to happen in the student loan program and still be in good standing.

We think that those types of measures are more robust and better accountability measures than the cohort default rate. And I should point out that this—the cohort default rate that everybody is referencing is the 2-year and sometimes 3-year cohort default rate—is not the lifetime default rate on these loans. The lifetime default rate on federal student loans is somewhere around 20 percent.

Mr. POLIS. But the issue I am trying to get at is how do we avoid masking through combining campuses so that it is reported in a way that may look optimal on paper but may mask deficiencies at some campuses vis-a-vis others.

Mr. DELISLE. I mean, it is something I guess the Department of Education would have to look at and how they allow institutions to define with what is their ID, what is the actual jurisdiction of a particular campus, but I am sure that they are able to get around that in some way.

Mr. POLIS. Any other comments on that issue?

And finally, last year I introduced a "Know Before You Owe Act" which would require private lenders to certify borrowers are enrolled in school and also it would require higher education institutions to inform students about their federal financial availability and eligibility. What we found is that some students were actually buying—while they had extra federal capacity, were still borrowing at higher commercial rates.

Briefly, for Mr. Draeger for the remainder of the time, how can we help students who are stuck in private loans make sure that they are aware of the opportunities that exist in low-interest federal loans?

Mr. DRAEGER. The best way to do that is by ensuring that the financial aid office has a comprehensive understanding of all of the offerings that a student has. That includes from the private markets. So a private student loan certification would ensure the financial aid office is brought into that decision.

Mr. POLIS. Thank you.

And I yield back.

Chairman KLINE. I thank the gentleman. I want to thank the witnesses for excellent testimony in answering our questions. I think you cleared up some things and frankly for some of us, we are more confused. But that is okay. We are going through a process here where we are addressing a problem that is increasingly recognized as a problem for our country, for students, for schools, and so we are going to continue to press on with this.

Mr. Tierney, any closing remarks?

Mr. TIERNEY. Just very briefly, Mr. Chairman. Again, I want to thank you for having this hearing and beginning the discussion.

I want to thank all of our witnesses for their contribution. It was valuable to all of us. We shouldn't lose sight of the fact, obviously, that were really looking at students and their families and trying to reach a policy goal here of graduating people with the appropriate credentials and abilities to help drive our economy forward and to give us a competitive advantage amongst other countries on that and to be innovative and creative on that.

So in that context, in the context of what is a good investment for this country and for the taxpayers, is I think the basis which we ought to consider all of the things that we heard today and I think we made a good start.

So thank you.

Chairman KLINE. Thank the gentleman.

There being no further business, the committee stands adjourned.

[An additional submission of Chairman Kline follows:]

Prepared Statement of the Education Finance Council

The Education Finance Council is the trade association representing nonprofit and state agency student loan organizations across the country. EFC commends the Committee for examining the current federal student aid system in order to benefit students and families. The members of EFC share this goal and believe there are several short- and long-term solutions to improve the system. In the short term, the student loan experience for borrowers can be enhanced through improvements to the Not-for-Profit (NFP) servicing program. Over the long term, the PLUS loan programs must be eliminated so students can choose consumer friendlier loans and fair value federal budget accounting must be implemented to provide an accurate account of the impact of federal student lending on the federal deficit, and ultimately, taxpayers.

The NFP servicing program, created by Congress, allows eligible not-for-profit student loan organizations to provide high quality loan servicing under the Direct Loan Program. NFP servicers that are under contract have been working closely with staff from Federal Student Aid and are taking extraordinary steps to ensure their borrowers are getting the best possible loan servicing experience. Customer service has been a focus of all NFP servicers and despite the difficult accounts they have been allocated to date, the NFP servicers have received customer service survey results and produced delinquency results that approximate those of the other, larger servicers. The benefits borrowers and the federal government are realizing can be enhanced by allocating more loans to the NFP servicers. Increasing allocation of loans, including newly originated Direct Loans, provides a reliable source of accounts NFPs can receive so that they can supply the high quality of service that Congress expects them to bring to more Direct Loan borrowers. The federal government benefits by increasing the allocation because any additional accounts beyond the initial 100,000 allocation means pricing equal to what is paid to Title IV Additional Servicers.

Improving the NFP serving program provides near-term efficiency for the Direct Loan program, but Congress must look beyond programmatic enhancements to the current federally-based student aid system and consider significant policy changes to truly create a better student aid system. Congress should eliminate both the graduate and parent PLUS programs and encourage schools to shift borrowing to consumer-friendly programs offered by nonprofit and state agency providers. As college costs continue to climb, students and parents need to be provided with alternatives to high interest rate loan products, such as the PLUS programs. Current policies that favor steering borrowers who need reasonable financing options beyond grant aid and Stafford loans into 7.9 percent PLUS loans are depriving them of options that will lower their debt burden. Nonprofit alternative loan programs feature fixed interest rates below the percent rate for PLUS loans and have consumer-friendly features such as low or no fees, institutional certification and flexible repayment terms. Moreover, nonprofit and state agency alternative loan programs have default rates that range from less than one percent to three percent. Finally, information available on nonprofit and state agency loans programs far exceeds what the

Department provides for PLUS loans. For example, as the Chronicle of Higher Education reported "U.S. Department of Education doesn't know how many parents have defaulted on [PLUS loans]. It doesn't analyze or publish default rates for the PLUS program with the same detail that it does for other federal education loans."[1] By contrast, nonprofit and state agencies actively monitor and disclose default rates and employ a range of steps—including reducing the amount borrowed from the outset, to ensure that students and parents are not taking out more than they can handle.

Finally, Congress must accept fair value rather than the current Federal Credit Reform Act (FCRA) method of estimating costs and savings for federal student aid programs. Adopting fair value accounting will allow policy makers to accurately evaluate new student aid programs that provide value to students, parents and taxpayers.

The debate about government accounting for student loans is not new. Dating back to 2005, the flaws of estimating costs under the FCRA method have been detailed. GAO pointed out:

"Additional federal costs and revenues associated with the student loan programs, such as federal administrative expenses, some costs of risk associated with lending money over time, and federal tax revenues generated by both student loan programs are not included in subsidy cost estimates.[2]

The Kansas City Federal Reserve Bank has acknowledged the benefits in utilizing fair value accounting to assess the cost to the federal government of the Direct Loan program. In their 2012 report Student Loans: Overview and Issues, Kelly D. Edmiston, Lara Brooks and Steven Shepelwich point out:

"Fair value estimates, which make additional adjustments for risk and also include administrative costs, provide a more complete picture of the cost of federal student loan programs. Fair value estimates calculated in March, 2010 CBO report projected a net cost of about 11 percent of lending for 2012. New direct loan volume is projected to be $121 billion in FY2013, yielding a net budget cost of $13.3 billion. About $28 billion in consolidation loans is expected, which would likely add an additional $3 billion. Using fair value accounting principles, the student loan program would account for about 0.4 percent of the president's FY2013 budget outlay request of $3.8 trillion."[3]

Fair value accounting gives Congress the ability to effectively consider alternatives to the Direct Loan program including securitizing loans held by the government and allowing the private sector to originate and service loans to credit worthy borrowers.

There is room for much improvement in the federal student aid system. Programmatic changes to certain elements such as the NFP servicer program can provide immediate benefits, however broad policy changes such as the elimination of the PLUS programs and a shift to fair value accounting are needed to create a fundamentally better, more sustainable system. EFC members have played a significant role in helping students and families finance higher education for decades and stand ready to help coordinate and implement beneficial changes to the student aid system.

[Additional submissions of Mr. Draeger follow:]

[The report, "Reimagining Financial Aid to Improve Student Access and Outcomes," may be accessed at the following Internet address:]

http://www.nasfaa.org/advocacy/RADD/RADD_Full_Report.aspx

[The report, "Report of the NASFAA Task Force on Student Loan Indebtedness," dated February 2013, may be accessed at the following Internet address:]

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[1] The Parent PLUS Trap, accessed March 11, 2013 at *http://chronicle.com/article/The-Parent-Plus-Trap/134844.*

[2] GAO-05-874 'Federal Student Loans: Challenges in Estimating Federal Subsidy Costs', October 26, 2005/

[3] Student Loans: Overview and Issues, RWP 12-05 at p. 15.

http://www.nasfaa.org/EntrancePDF.aspx?id=13507

[The report, "Report of the NASFAA Award Notification and Consumer Information Task Force," dated May 2012, may be accessed at the following Internet address:]

http://www.nasfaa.org/EntrancePDF.aspx?id=9992

[Questions submitted for the record and their responses follow:]

U.S. CONGRESS,
Washington, DC, April 3, 2013.

Mr. JUSTIN DRAEGER, *President and CEO,*
National Association of Student Financial Aid Administrators, 1101 Connecticut Avenue NW, Suite 1100, Washington, DC 20036-4303.

DEAR MR. DRAEGER: Thank you for testifying at the March 13, 2013 hearing on "Keeping College Within Reach: Examining Opportunities to Strengthen Federal Student Loan Programs." I appreciate your participation.

Enclosed are additional questions submitted by members of the committee after the hearing. Please provide written responses no later than April 16, 2013 for inclusion in the final hearing record. Responses should be sent to Amy Jones or Emily Slack of the committee staff who can be contacted at (202) 225-6558.

Thank you again for your important contribution to the work of the committee.

Sincerely,

JOHN KLINE, *Chairman,*
Committee on Education and the Workforce.

REPRESENTATIVE RICHARD HUDSON (R-NC)

1. There has been a lot of talk about a "student loan bubble." Do you think we are about to see the collapse of student loan programs because too many people are borrowing to pay for college? What would the collapse of this bubble mean for the economy and for the students who are preparing for college now?

REPRESENTATIVE MARTHA ROBY (R-AL)

1. I know financial aid administrators are concerned about the impact of sequestration on student financial aid programs, particularly right now as campuses are starting to put together financial aid packages for incoming students. How forthcoming has the Department of Education been with the campus community about the impact of the cuts?

REPRESENTATIVE RAUL GRIJALVA (D-AZ)

1. NASFASS'S Debt Task Force recently recommended allowing colleges to limit students' eligibility for loans based on things like their program length or program type and allowing professional judgment to approve increased borrowing on a case-by-case basis (flipped from current policy that allows for limiting borrowing on a case by case basis). However, NASFAA's recent RADD white paper said "Restrictions on federal loan borrowing could drive students to borrow under less advantageous private loan programs, discourage some students from enrolling, or cause more enrolled students to drop out due to lack of funds." What evidence can you point to that would outweigh the risk of forcing students to drop out, not enroll, or turn to riskier forms of borrowing?

Mr. Draeger's Response to Questions Submitted for the Record

REPRESENTATIVE RICHARD HUDSON (R-NC)

1. There has been a lot of talk about a "student loan bubble." Do you think we are about to see the collapse of student loan programs because too many people are borrowing to pay for college? What would the collapse of this bubble mean for the economy and for the students who are preparing for college now?

Draeger: The size of the mortgage market at the height of the housing bubble in 2006 dwarfs the current student loan market. Using rough estimates, the current

student loan market is valued at roughly $1 trillion. At the height of the housing boom in 2006, the residential housing market was worth $22 trillion—more than 22 times larger. When the mortgage bubble burst, it lost nearly $8 trillion in value (Baker, 2012). Even if every borrower defaulted on his or her student loan at the exact same time (an impossibly unlikely scenario), it wouldn't have the same impact on the economy as the housing collapse.

However, it stands to reason that as students and parents take on more debt to pay for college, they could be delaying other financial decisions such as purchasing a home, buying a car, or otherwise participating in the economy through consumer purchases. Still, federal student loans bet on the likelihood that the borrower's financial circumstances will improve through the education or training being financed, and that as a result the borrower will repay the loan over time. For most students and for society in general, this is a good risk to finance.

Systemic economic risk is further reduced by the fact that federal loans make up the large bulk of the student loan market and collection rates are much higher than private sector collections. As long as the program contains reasonable and effective repayment terms like income based repayment—which act as safety valves—the loan program should remain healthy. The loss of the student loan program would be disastrous: without student loans, higher education in this country would be impossible for many low- and middle-income students. The loss of a broadly educated work force is untenable in today's world economy.

But more can be done to strengthen the programs and protect borrowers. Underwriting standards might need to be examined for parent borrowers to see if they provide adequate protections to both the borrower and the government as lender. For undergraduate borrowers, there are loan limits in place to ensure borrowers stay within permissible amounts, but aid administrators need broader authority to limit indebtedness for students whose borrowing is not-on-pace with their program. Such a proposal is included in my written testimony.

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1. I know financial aid administrators are concerned about the impact of sequestration on student financial aid programs, particularly right now as campuses are starting to put together financial aid packages for incoming students. How forthcoming has the Department of Education been with the campus community about the impact of the cuts?

Draeger: Financial aid administrators are always concerned when cuts are made to the federal student aid programs, including the cuts imposed by sequestration. The impact of sequestration has been especially difficult given the timing—some of the scheduled cuts were occurring at the same time aid administrators were delivering award letters to new and continuing students based on non-sequester estimates previously delivered by ED.

It is unclear to us why OMB did not release more specific estimates that would have allowed ED to provide schools allocations at a post-sequester amount given that the sequester was in the law and everyone knew its effective date. In fact, institutions across the U.S. relied on rough estimates created by us to construct their awarding packages. If NASFAA could create fairly reliable estimated campus-based cuts assuming sequestration, certainly the government could have done the same.

Since the sequester went into effect March 1, ED has provided regular communication and guidance about how to implement sequester cuts and/or how to temporarily proceed until final implementation instructions could be made. ED has also been responsive to NASFAA's requests and questions since March 1.

REPRESENTATIVE RAUL GRIJALVA (D-AZ)

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Draeger: The passage being referenced from our Bill and Melinda Gates Foundation-funded Reimagining Aid Delivery and Design paper was offered as a "possible unintended consequence" of giving aid administrators the authority to limit loans for specific categories of students. We offered this thought as part of making an in-

tellectually honest policy argument that examines all sides of an issue. The simplest and most effective way to deal with such an unintended consequence is to require that all private education loans be certified through the financial aid office just like federal loans. That would ensure students are having conversations with financial aid administrators before dipping into the private market and would further ensure that students borrow within the federal loan programs before turning to riskier private loans.

REFERENCES

Baker, D. (2012, March 11). Student Loan Bubble. Retrieved From *http://www.cepr.net/index.php/blogs/beat-the-press/student-loan-bubble-nonsense-peter-peterson-and-the-washington-post-mess-up-on-the-economy-yet-again*

U.S. CONGRESS,
Washington, DC, April 3, 2013.

Mr. JASON DELISLE, *Director,*
Federal Education Budget Project, the New America Foundation, 1899 L Street, NW, Suite 400, Washington, DC 20036.

DEAR MR. DELISLE: Thank you for testifying at the March 13, 2013 hearing on "Keeping College Within Reach: Examining Opportunities to Strengthen Federal Student Loan Programs." I appreciate your participation.

Enclosed are additional questions submitted by members of the committee after the hearing. Please provide written responses no later than April 16, 2013 for inclusion in the final hearing record. Responses should be sent to Amy Jones or Emily Slack of the committee staff who can be contacted at (202) 225-6558.

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Mr. Delisle's Response to Questions Submitted for the Record

REPRESENTATIVE RICHARD HUDSON (R-NC)

Nearly all outstanding and newly-issued student loans are federal loans. It would be hard to imagine that program "collapsing" because the funding for it is provided directly by the federal government. That is, this source of financing for higher education would only become unavailable if lawmakers made it so. In that regard the student loan program cannot collapse unless Congress and the president enacted a law forcing it to collapse. I see that issue as a separate one from whether students are borrowing too much to pay for college.

Nevertheless, rising levels of outstanding total federal student debt (somewhere around $1 trillion, nearly all federal) have raised concerns that students are borrowing too much and that will have economy-wide effects. I believe that matter is best discussed by focusing on undergraduate students and graduate students as two separate groups.

For undergraduates, while are greater share of students are leaving school with some debt, the amount of debt that they leave with on average has not risen in real, inflation-adjusted terms by much in the past 10 years. The figure is somewhere around $25,000 today. Furthermore the federal government limits the amount undergraduates can borrow in federal loans to about $30,000 for dependent undergraduates.

A borrower could make payments as low as $143 per month on a loan of $25,000 with a 6.8 percent interest rate under the consolidation repayment plan. His payment could be lower, even $0, under the Income Based Repayment plan, and he can postpone payments for up to 3 years under the forbearance terms if he is having financial difficulties. In short, an undergraduate with the average amount of debt can make very affordable monthly payments on his loan under the federal student loan program. They are hardly figures that one would equate with a bubble.

Graduate student debt is a different story. Over 30 percent of outstanding and newly-issued loan volume is for graduate and professional education (although only 10 percent of borrowers are/were graduate students). These borrowers can accumulate very large balances mainly because the federal government allows them to borrow to finance the entire costs of their educations as defined by institutions of higher education, including living expenses. There is no annual, aggregate, or lifetime limit. When we hear stories about graduates with $100,000 in student loan debt, but earnings prospects that cannot service such a debt level, the stories are almost always about graduate students, not undergraduates. This is where there is a bubble in the student loan market—but it is not a loan bubble, it is a cost bubble. Unlimited federal student loans let graduate schools charge sums that are not justified given the future incomes that their graduates may earn.

I should stress, however, that this system will not necessarily collapse. Again, the federal government makes the graduate student loans available as an ongoing entitlement. Absent a change in law, students can continue to borrow at current rates. Worse yet, recent changes to the Income Based Repayment program (Pay As You Earn), which allows for low payments and unlimited loan forgiveness, gives students an incentive to borrow more, not less. That suggests that the graduate school cost bubble will not burst anytime soon.

[Whereupon, at 12:11 p.m., the committee was adjourned.]