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FINANCIAL PRODUCTS FOR STUDENTS: ISSUES AND CHALLENGES

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED THIRTEENTH CONGRESS

SECOND SESSION

ON

EXAMINING ISSUES RELATED TO FINANCIAL INSTITUTIONS AND POST-SECONDARY EDUCATION, INCLUDING PRIVATE STUDENT LOANS, STUDENT LOAN SERVICING, STUDENT LOAN DEBT COLLECTION, AND REFUND BALANCE CARDS

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C O N T E N T S

THURSDAY, JULY 31, 2014

FINANCIAL PRODUCTS FOR STUDENTS: ISSUES AND CHALLENGES

THURSDAY, JULY 31, 2014

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Committee met at 10:02 a.m., in room SD–538, Dirksen Senate Office Building, Hon. Tim Johnson, Chairman of the Committee, presiding.

OPENING STATEMENT OF CHAIRMAN TIM JOHNSON

Chairman JOHNSON. Good morning. I call this hearing to order.

Financial institutions play a role in higher education in many ways, from private student loans to student loan servicing, debt collection, and campus banking. Student loan debt is currently $1.2 trillion and continues to be the largest form of consumer debt in the country after mortgages. This issue is especially important to me, as my home State of South Dakota has a higher percentage of students graduating with debt than any other State in the country, at nearly eight in ten students.

Rising student loan debt affects everyone and undermines our economic recovery. Increasing numbers of Americans with student loan debt are putting off buying a home, starting a business, and saving for retirement, and high student loan debt makes it harder for students to stay in rural communities like South Dakota.

While the level of student loan debt is significant, equally significant are the level of delinquencies and the options for borrowers in repayment. Recent data shows that nearly one-third of borrowers are delinquent and borrowers are entering delinquency faster than before the financial crisis. The CFPB has found that borrowers are unable to obtain affordable repayment options and have difficulty working with student loan services to correct payment errors. Last year, I held a hearing on this issue, encouraging lenders to work with borrowers to avoid default.

A few months ago, the CFPB began overseeing large student loan servicers, which brings an estimated 49 million borrowers' accounts under its watch. This is an important step. However, we saw in the mortgage crisis that responsible servicing is a critical component of loan management.

Both the Education Department, as the originator of Federal student loans, and private student lenders have a duty to ensure that their loans are effectively managed every step of the way. This means making sure students have full access to information about their loan options before taking on debt and providing affordable loan repayment, responsible servicing, and careful debt collection.

Financial institutions have also partnered with a number of higher education institutions to offer debit and prepaid cards to students, sometimes as a means to facilitate Federal student loan refunds. I look forward to hearing more about these arrangements, including what impact these relationships may have on students.

With that, I turn to Ranking Member Crapo.

STATEMENT OF SENATOR MIKE CRAPO

Senator CRAPO. Thank you, Mr. Chairman.

Beginning the path to higher education is filled with great excitement and opportunity for students across the country. However, students are faced with financial questions they might not have considered until this point, such as how they will pay for college, whether they should finally open a bank account, and how they will budget their money.

Banks and credit unions throughout the country serve an important role helping students sort through these financial issues in this new chapter in their lives, and many entities provide financial literacy tools to help students improve their understanding of the financial burdens they are about to undertake.

Today, I will focus on two issues that impact students and their financial institutions in the higher education market. First, in the student loan market, both Federal and private, there has been a growing field of research focused on the high student debt burden, now roughly $1.2 trillion, as the Chairman indicated, and its impact on the financial opportunities and decisions of recent college graduates.

Recently, the CFPB noted that the Federal Government's share of outstanding total student debt topped $1 trillion for the first time, roughly five times higher than existing private student loan debt. I share my colleagues' concerns about the negative impact of high student debt on the financial lives of recent graduates. I also have concerns about the significant and increasing role of the Federal Government in this market, which ultimately leads to excess exposure for U.S. taxpayers and diminished student borrowing choices.

The factors we should be focusing on are the rising cost of college and failure to inform students properly about the loan repayment process before starting school. Since 1974, the cost of college has risen roughly 350 percent. There have been relatively few market forces to keep costs down, as students can borrow up to the cost of attendance for an undergraduate program and take out almost unlimited Federal loans in graduate school.

Students are not adequately educated about the impact their borrowing will have on their life after graduation. It is unclear if students have the proper information to compare loan types, earning potential for different career choices, and what their monthly payments will look like when they graduate. These issues should be addressed before a student ever receives a loan.

The second issue I would like to discuss today is the Department of Education's proposed rulemaking for the Federal student loan disbursement process, an issue that has received bipartisan attention. As drafted, the proposal would impact student accounts that are completely unrelated to the Federal student loan disbursement process, which may cause unintended consequences for students and colleges and universities.

With the proposed rule, the Department of Education creates an indirect back door regulation of bank products, requiring them to alter features for accounts that may never be used by a student to receive a student loan disbursement. Unfortunately, this could force banks and credit unions to simply exit campus markets, leading to diminished student choice, restricted convenience, and more unbanked young people. As the Department of Education moves forward, it must work with the prudential banking regulators to understand the compliance challenges its rule may introduce and the negative impact it could have on the supervision of banks and credit unions.

There is no doubt the financial challenges associated with higher education today can be daunting for students. I look forward to hearing from our witnesses about how we can improve our student financial options, convenience, and financial literacy.

Thank you, Mr. Chairman.

Chairman JOHNSON. Thank you, Senator Crapo.

Are there any other Members who would like to give a brief opening statement?

Senator MORAN. Mr. Chairman?

Chairman JOHNSON. Senator Moran.

STATEMENT OF SENATOR JERRY MORAN

Senator MORAN. Mr. Chairman, thank you very much. I would ask unanimous consent that a letter that I will submit to you from the seven Regents institutions in Kansas be made a part of the record.

Chairman JOHNSON. Without objection.

Senator MORAN. Thank you.

Mr. Chairman, let me just for my opening statement highlight, and it is the last part of what Ranking Member Crapo was indicating. Our seven Regents Universities in Kansas—Emporia State, Fort Hays State University, Kansas State University, the University of Kansas, Pittsburg State University, and Wichita State University—are all expressing concern, while they support the general concepts of the direction the regulations, the rulemaking is going. The particular issue that Senator Crapo just mentioned in regard to other accounts is a significant issue for them and for their students.

The letter basically indicates that they agree with the Department's stated objectives, to ensure that students have safe, convenient, and free access to credit balances in their accounts. They want to raise the issue in regard to the regulation that would, quote, "regulate any arrangement under which a student opens or is referred to open a financial account into which Title 4 HEA program funds may be deposited." Such a regulation could be interpreted to cover any account held by the student or parent if the financial institution had any arrangement, however informal, with that school, and regardless of when and why the student or parent opened the account with that financial institution.

That would have a chilling, and in some cases terminal, effect on good business partnerships that currently benefit students and universities alike. Students, often far from home, need access to safe and secure financial services. Financial experience is a necessary part of student life and is essential training in their long-term financial health. Knowing this, many schools have signed agreements with banks to provide on-campus financial institutions at low or no cost to students. Such services include secure on-campus branches, ATMs, debit cards, and financial education programs.

Any regulatory action that could potentially take away students' safe, convenient, and free access to one group of essential services while it simultaneously drives up the cost of education for that same group of students deserves to be studied with extraordinary care.

I would ask that, as I said, the letter be made part of the record, and I hope the witnesses will address the concerns that I have raised.

Thank you very much, Mr. Chairman.

Chairman JOHNSON. Thank you.

I would like to remind my colleagues that the record will be open for the next 7 days for additional statements and any other materials you would like to submit.

Now, I will introduce our witnesses. David Bergeron is Vice President for Postsecondary Education Policy at the Center for American Progress.

I recognize Senator Warren to introduce our next witness.

Senator WARREN. Thank you, Mr. Chairman.

I would like to introduce Christine Lindstrom, the Higher Education Program Director for U.S. PIRG Student Chapters. Ms. Lindstrom is a 14-year veteran of the Student PIRGs and she now works with a PIRG chapter to organize campaigns across the country for more affordable, more accessible higher education. Her work has helped make college more affordable for American students, whether it is pushing for reforms through the College Cost Reduction and Access Act or advocating for lower-cost textbooks.

So, Ms. Lindstrom, it is good to have you here today. Thank you for coming.

Chairman JOHNSON. Kenneth Kocer is the President of the South Dakota Association of Student Financial Aid Administrators and Director of Financial Assistance at Mount Marty College in Yankton, South Dakota. Ken, I thank you for traveling all this way from South Dakota to testify before us today. I know you have been in the financial aid sector for almost 25 years and I look forward to hearing more about your expertise in helping students make smart decisions across South Dakota and the country.

Richard Hunt is President and CEO of the Consumer Bankers Association.

I thank you all for being here today. I would like to ask the witnesses to please keep your remarks to 5 minutes. Your full written statements will be included in the hearing record.

Mr. Bergeron, you may begin your testimony.

STATEMENT OF DAVID A. BERGERON, VICE PRESIDENT FOR POSTSECONDARY EDUCATION POLICY, CENTER FOR AMERICAN PROGRESS

Mr. BERGERON. Thank you, Mr. Chairman, and thank you to the rest of the Committee for inviting me to be here today.

We are at a critical moment of the year. Our young people are in the process of preparing to go off to college, many for the first time, and they are going to be dealing with issues that they have never had to deal with before, as was mentioned in a couple of the opening statements.

And, when we think about that experience that our students have, it is different than the one we had. Today, 21.5 million students will be enrolling in our 7,500 institutions and 12 percent of them will be going online. You know, when I went to school, there was no such thing as online, never thought of anything like that happening.

And, so, the student population is experiencing different things, and one of the things that is very different is the level of debt that they are taking on. Students graduating with a Bachelor's degree in 2011–2012 graduated with $26,500 in student loan debt. That was an increase in just 4 years of 33 percent. Graduate students graduated with $55,600 in debt. That was an increase of 46 percent in just 4 years.

And, while I worry a lot about the students who graduate from our institutions of higher education, the level of debt they are taking on, I also worry, and probably worry more, about students who are taking on debt and are failing to graduate. And, 10 percent of the students who drop out from our institutions reported debt levels of $33,000 or more. That has to be a concern.

I am also concerned about the students who take on a mix of private and Federal loans, and I point out in my testimony the difference in borrowing levels for those students who take on both private and Federal loans. It is much higher. It is much more concerning. And this affects, as several of you indicated in your statements, the life choices that students can make—whether they form a household, whether they buy a car, whether they buy a house, whether they start a small business. So, we know that there are concerns, and legitimate concerns.

Some people argue that this is not new. You know, there is a recent study by another organization that said things have really not changed, and I would assert they really have changed, because the authors of the study, I think, discount one of the findings, and that is the length of time that it takes to repay student loans. They say that it went from 7.4 years or 7.5 years to over 13 years. That is a huge impact on a family's ability to save for retirement, for their own children's college education. And, so, we need to pay particular attention to that.

The Center for American Progress has indicated very strong support for doing something about refinancing student loans, both Federal and private, and we believe that that is a critical issue and one that we need to address.

We have also indicated that there needs to be some reforms in the bankruptcy protection that is afforded to student loans, both Federal and private. Private and Federal student loans are not dischargeable in bankruptcy currently today. That is something that exists for nearly all other borrowers in our economy, whether small businesses or individuals, and it really needs to be rethought so that students who enroll in programs that were of high quality but where the industry they were seeking to enter disappears because of changes in technology or the economy should not have that hamper them permanently and hamper them in ways that prevent them from being able to do the things that they need to do for their families or to improve our society by starting small businesses.

I would like to talk for a minute about the issue of student loan servicing. I tell the story in my written testimony of the development of state-of-the-art world class regulations for servicing debt in the 1970s, and clearly, things have changed since the 1970s and we really need to update the way that we service and handle our student loan portfolios, whether they are Federal or private. We need to really improve those and develop and implement state-of-the-art tools.

With that, I am happy to answer any questions that you have when you get to that point in the hearing.

Chairman JOHNSON. Thank you.

Ms. Lindstrom, please proceed.

STATEMENT OF CHRISTINE LINDSTROM, HIGHER EDUCATION PROGRAM DIRECTOR, U.S. PUBLIC INTEREST RESEARCH GROUP

Ms. LINDSTROM. Thank you, Chairman Johnson and other distinguished Senators, for giving me the opportunity to speak. Once again, I am Chris Lindstrom with the U.S. Public Interest Research Group.

The topic of today's hearing is broad, so I will focus my remarks on issues that U.S. PIRG has been actively tracking and promoting, specifically in the campus banking space, which has come up in several Senators' introductions.

Since 2007, we have worked to ensure that students are protected from tricks and traps that are layered into high-cost products like campus credit cards, private student loans, and campus bank accounts and debit cards. Right now, students are being hit with high fees that are hard to avoid as they try to access their Federal aid refunds through campus-sponsored bank accounts and prepaid debit cards.

We found in our 2012 report, "The Campus Debit Card Trap", that two in five student students in the country are exposed to debit cards on campus that may drive up their costs. Students at some campuses are charged steep and unusual fees to get to their Federal financial aid, including PIN transaction fees at the point of sale, overdraft fees at $37 or more. On the whole, these accounts are not necessarily a better deal for students than what they might find through a bank not affiliated with the campus.

Still, industry leading banks and financial firms can see 40 to 75 percent of students on a campus using the campus bank product after—a campus-based product after a few years of marketing. So, how do they do it?

First, banks and financial firms behind these products often rely on multimillion-dollar revenue sharing agreements with campus administrations. The contracts include receiving direct payment to use the school's logo, providing bonuses for recruiting students, and discounted pricing in exchange for marketing access.

In addition, they use push marketing and other strategies to steer students into opening up these new accounts over using their existing bank accounts. Higher One, a prominent financial firm in this market, premails a card to every student on campus before they have opted in or out. The cards are cobranded with the college logo, giving the impression that the student must open the account.

At another college, bank representatives actually set up tables right outside the student ID office, essentially aggressively promoting their accounts that students can link to the student ID cards. Students can get freebies, like bags and T-shirts, for signing up.

Finally, the fees can be high, as I mentioned, and unusual. Fees on university-sponsored cards include a variety of PIN swipe fees, inactivity fees, overdraft fees, ATM surcharges, fees to reload prepaid cards, fees to check your account balance. I could go on. The fees can be hard to avoid, for example, if a merchant only accepts PIN debit or there is no fee-free ATM available.

All campus bank accounts and prepaid card services can charge overdrafts. Overdraft coverage is a form of credit, since the financial institution covers the consumer's shortfall and is subsequently repaid the amount extended plus a fee. Some banks engage in the abusive practice of purposely reordering transactions to maximize overdraft fees. Many banks and financial firms that are playing on campus right now have been held accountable for their abusive practices in this arena.

Overdraft fees are inconsistent with the Department of Education's existing rules on school-sponsored accounts. Department of Education rules also require that students be provided convenient fee-free ATM access. In practice, access can be limited.

One argument that is being made in defense of these campus banking products is that too many low-income students are not able to acquire a bank account other than on campus. These are the unbanked students. The Consumer Financial Protection Bureau found that less than half a percent of college students in America are legitimately unable to secure a bank account. So, a new student who comes onto campus without a bank account, she does not have one because she chose not to have one or she has not gotten one yet. Students do not need campus-sponsored bank accounts.

So, I urge you to consider legislation that bans revenue-sharing agreements between colleges and banks or financial firms crafted specifically to offer bank accounts and related banking products to students on campus. The conflict of interest inherent in these accounts is problematic for the student consumer and it needs to be addressed. Thank you.

Chairman JOHNSON. Thank you.

Mr. Kocer, please proceed.

STATEMENT OF KENNETH KOCER, DIRECTOR OF FINANCIAL ASSISTANCE, MOUNT MARTY COLLEGE, YANKTON, SOUTH DAKOTA, AND PRESIDENT, SOUTH DAKOTA ASSOCIATION OF STUDENT FINANCIAL AID ADMINISTRATORS

Mr. KOCER. Chairman Johnson and Members of the Committee, thank you for inviting me to testify this morning on the important topic of private education loans.

At Mount Marty College, we actively promote the Federal Student Loan Programs for students as their first and best option when considering a loan to assist with educational costs, as do my colleagues across South Dakota. In particular, Financial Aid Administrators counsel students on the many benefits of the Federal Student Loan Program, including the availability of subsidized interest for certain borrowers, options for loan forgiveness, and multiple generous repayment plans. Beyond these benefits, the Federal Direct Loan Program also offers deferment and forbearance options, Federal consolidation opportunities, and in many instances, lower interest rates.

Even with students being counseled to utilize and exhaust the Federal student loans available to them, some still find that they need additional resources. Private loans can fill the gap in certain cases by funding a student's educational costs when Federal resources fall short.

Institutions in South Dakota generally have a lower tuition rate when compared to other States, yet even we find that some students need to utilize private education loans. In surveying my colleagues throughout the State, as many as one-third of students on some campuses receive private education loans.

I would like to share with you an example of the gap I described that may cause a student to utilize a private student loan in order to cover educational costs. Let us say an institution costs $18,000 for tuition, fees, room and board, setting aside now any indirect costs, like books, transportation, and personal costs they may incur. If the student is not Pell Grant eligible, the only guaranteed Federal eligibility the student has as a first year dependent undergraduate student is a direct loan in the amount of $5,500. Going back to our $18,000 school, this leaves over $12,000 which the student would need to find a way to fund. Lacking parental support, this shortfall in Federal loan eligibility leaves a student looking to other options. For this reason, private student loans with proper consumer protections do fill an important need for some students.

I would like to now briefly walk through the processing procedure for private student loans. It begins with the student selecting a private lender they feel best suits their needs. In South Dakota, a number of schools provide a site where the students can access a historical list of private loans that students at that institution have utilized in the past. Importantly, providing historical lists of private education loans is different than providing a preferred lender list, in which case the schools recommend specific lenders to students. A historical list displays features of different private loan programs, enabling students to make comparisons that hopefully lead to an informed decision.

Once a student selects the private loan they wish to borrow, they apply for the loan directly through the private lender. The lender approves the loan. The certification request is sent to the school. The school reviews the student's educational cost of attendance and the financial aid resources that the student has already received, for example, Federal loans and grants, to determine the amount of the private loan for which the student is eligible. An appendix to my written testimony provides a specific example of this.

By involving the school in the private loan certification process, it allows the school to track all borrowing the student is incurring and counsel the students on the overall amount of their loan debt. From an institutional perspective, we consider this a good practice, as it provides us with more information to assist in preventing students from over-borrowing. Through the process of certifying private loans, the school can ensure the student has not borrowed beyond the calculated cost of attendance.

There are quite a few private lending institutions that currently utilize school certification as a prerequisite in determining whether the student is eligible for their private loan or not, but lenders are not required to do so.

Having provided some context on private education loans, I would like to offer the following recommendations to improve the private loan process for all borrowers.

Recommendation one is to require school certification for all private education loans. The current private education loan application process should be revised to continue to counter the impact of lender marketing and to assist in managing student over-borrowing. Replacing student self-certification with full school certification would give institutions the opportunity to ensure that a student is aware of the benefits of the Federal loans before a student commits to a potentially less favorable private loan. Additionally, by requiring that an aid administrator review the student's remaining eligibility under the cost of attendance limits, we can help reduce unnecessary or inappropriate student borrowing.

Recommendation two, provide one single Web site where students can see all their educational borrowing from the Federal, institutional, and private sources. SDASFAA supports NASFAA's recommendation to create a universal loan portal for students. Congress should mandate the creation of a single loan portal where students can easily access information on all their student loans. This would allow all educational loans from the Federal Government, private lenders, and colleges and universities to be reported to one central data base.

Students need an accessible one-stop shop where they can manage their student loans. Many borrowers have multiple loans with different loan holders that may be in various stages of repayment. Having a central Web site where students can view their access on all their loans would significantly help students as they manage their borrowing and repayment.

The creation of such a resource could result from the expansion of the data collected by the National Student Loan Data System, NSLDS, which only partially serves the purpose at this time.

Thank you for the opportunity to speak today, and I look forward to any questions you may have.

Chairman JOHNSON. Thank you.

Mr. Hunt, please proceed.

STATEMENT OF RICHARD HUNT, PRESIDENT AND CHIEF EXECUTIVE OFFICER, CONSUMER BANKERS ASSOCIATION

Mr. HUNT. Chairman Johnson, Ranking Member Crapo, Members of the Committee, a very good morning. My name is Richard Hunt. I am President of the Consumer Bankers Association, a trade association for today's leaders in retail banking.

This hearing is most timely, as many of the Nation's 21 million students are preparing to head for campus. The need for fair, clear, and transparent products for these students has never been more important. CBA's members provide student loans and banking services to some of the Nation's college students and their families. I appreciate the opportunity to offer insights on these products, services, and associated marketplaces.

Before I address the topic of today's hearing, we cannot ignore the real crisis facing students and their families, the rising cost of a 4-year college education. Since 1980, the average tuition for a 4-year degree has risen 1,100 percent, more than four times the rate of inflation. Over half of our college students need some form of financial need. We must make college more affordable or we allow this to snowball to the detriment of our Nation's future leaders.

We strongly believe in the pursuit of higher education. It is absolutely critical for economic mobility, the success of our Nation's economy, and international competitiveness. We have a sacred bond with our students and play an important role as they begin their financial and professional futures by developing a good credit rating and aiding them in earning a college education.

Private and Federal loans have a complementary role in helping students achieve their educational goals. However, private student loans are but a sliver of the overall marketplace. Today, 92 percent of all student loans are originated by the Department of Education, and they alone have over $1 trillion on their balance sheet.

Unlike Federal loans, private student loan applications undergo a robust underwriting process based on a variety of factors, including, and most importantly, a determination of the borrower's ability to repay the loan. Private lenders encourage the use of cosigners, resulting in lower interest rates for the student. Ninety percent of student loans have a cosigner. Since private student loans do not carry a Government guarantee, the lender bears the risk of loss, not the taxpayer.

Private lenders have strengthened underwriting standards, resulting in remarkably lower delinquency and default rates. Just this week, a new report came out by MeasureOne that found that less than 3 percent of private student loans were 90 days or more delinquent—three percent. On the other hand, the Federal Loan Program has a current default rate of 14 percent, with some reports estimating more than 40 percent of the loans will be in default or become delinquent.

We are committed to working with students one on one, utilizing every tool necessary, including restructuring, refinancing, and deferment. Private student loan lenders are required to provide disclosures at multiple times throughout the origination process. These urge students and their families to look at the Federal Loan Programs before opting for private loans. It is up to each borrower to determine the right mix of Federal and private loans to meet their educational needs.

In addition to the small but critical role in the student lending market, CBA members play an important role by offering basic banking services on campus, such as checking and savings accounts designed to meet students' unique needs and help establish their credit history. In some cases, banks do partner with educational institutions to offer services, such as accounts linked to student ID cards, financial literacy programs, and assistance with financial aid systems. The accounts offered through negotiated agreements often have student-friendly fee structures, are fully and transparently disclosed, and are completely optional for students.

Recently, the Department of Education entered into a negotiated rulemaking on the topic of cash management. This includes the disbursement of student aid refunds, or Federal aid in excess of what is needed to pay school tuition and fees. We worked in good faith with the Department and are disappointed a consensus was not reached. We have serious objections to the direction of this draft rule. A bipartisan group of 54 of your House and Senate colleagues, including Senators Klobuchar, Franken, Heller, and now Moran, have similar concerns.

While the Department has the authority to write rules concerning Title 4 financial aid disbursement, the proposed rule would go much further by regulating the availability and terms of financial accounts. This includes debit and prepaid cards available to students from already heavily regulated and well supervised depository institutions. We believe this to be outside the Department's scope. Whether it is a college-affiliated checking account or a private student loan, we want to offer these products in a way that serves the student well.

Thank you for the opportunity to testify.

Chairman JOHNSON. Thank you for your testimony.

As we begin questions, I will ask the Clerk to please put 5 minutes on the clock for each Member.

Mr. Bergeron, many student loan borrowers are unable to refinance their student loans and have thus been locked out of taking advantage of historically low interest rates. What challenges exist in refinancing student loan debt, and what recommendations do you have to address this issue?

Mr. BERGERON. As I indicated in my testimony, Mr. Chairman, I think the issue of refinancing student loans is perhaps the most critical. It would give the borrowers the ability to take Federal loans, combine them with private loans, and repay them as a single package with their total debt being considered.

The Center for American Progress released a report last year where we made specific recommendations for refinancing and we have worked with staff from both the House and Senate, and Republicans and Democrats, to propose and work on legislation to carry out that. Senator Warren has a bill that was voted on and did not reach the requisite number of votes to move forward, and I hope and expect that that will be something that is taken up again by the Senate. I think, in the long term, we have to find a solution, and the solution that has been offered by Senator Warren is a good one.

I think that if we cannot move forward with that, there are other proposals that have been put forward by members that should be considered. The idea of creating a conduit-like vehicle, as was done under the Ensuring Continued Student Loan Access Act a couple of years ago to make student loans available during the credit crisis provides a mechanism, a model for the kinds of public–private partnership that could be created to create a marketplace for consolidation loans, particularly those that are distressed.

But, I think, as a first order, we should look really hard at what already is pending before the Senate.

Chairman JOHNSON. Mr. Kocer, do you support mandatory certification of private student loans? How does certification help student borrowers, and in what way does your institution, Mount Marty College, use certification to meet its own need for information about student debt?

Mr. KOCER. It is very important for school certification, because it gives us more contact with the borrowers, first of all. So, when a school certification comes in, we know that there is an additional loan that student is looking for, and then we have the opportunity to counsel them on how that loan will affect them and what the possible repayment could be for them. So, that is the first advantage of having them all school certified, is we get that contact with the borrower to give them that up-front counseling on how it could affect them further on.

And, it also helps us with school certification to prevent over-borrowing for a student, because using school certification, we only allow them to borrow up to the maximum cost of attendance at our institution, so that will prevent them from over-borrowing and taking out additional loans not specifically for educational purposes.

Chairman JOHNSON. Ms. Lindstrom, last month, President Obama announced an expansion of the Pay as You Earn Program. Can you discuss why this proposal is important and whether you believe more needs to be done to improve repayment options for borrowers.

Ms. LINDSTROM. Yes, absolutely. I mean, David mentioned the $1.2 trillion, as did you, Mr. Chairman. Obviously, that is not only a drag for the individual borrowers behind that figure, but a drag on the economy more generally. So, it is important to make income-based repayment options attractive to as many borrowers as possible. And, President Obama's action would enable more than five million more borrowers to take part, or partake in that benefit than previously, and so I do think that that is very important and it is, as I mentioned, important to make those opportunities attractive for borrowers.

That said, I do think that borrowers who do qualify for these benefits are not getting into these programs, and that actually is another big problem that I would love to see lawmakers tackle. There is a major system failure where borrowers who qualify for these alternatives that could be beneficial to them are not getting into these programs. So, we have to figure out a way to deal with that, to look at the way the servicers are being compensated, and to ensure that there is a smooth path for borrowers in distress to be able to access the Pay as You Earn Program, now with an expansion component, and some of the other alternatives that are there.

Chairman JOHNSON. Senator Crapo.

Senator CRAPO. Thank you, Mr. Chairman.

Mr. Hunt, since the termination of the Federal Family Education Loan Program in 2010, there has been a dramatic change in the student loan market structure. The private sector markets are contracting and the Federal market is growing significantly. I am concerned that this reduces student borrower options. Could you describe the current state of the private student loan market and how that compares to the Federal market and maybe explain why we are seeing this dynamic.

Mr. HUNT. Sure. Thank you very much for the question. We have gone from about a $24 billion industry to about an $8 billion industry, and yet performance rating for our banks have gotten much better. Many of our banks have exited the student lending business. There are a few others that are thinking about it as we speak. We have a 3-percent default rate.

We flipped the equation, Senator. We do not want to look at a refinancing option. We do not need to because we do all the work at the front end. We make sure consumers have an ability to repay. There is nothing worse than telling a student at the very beginning of their career, we are not sure you can afford the loan we are about to give you. We do have self-certification. Ninety-seven percent of our loans are certified by the institution. When it is time to repay the loan, we work with the student many, many different ways, including offering deferment and refinancing the student. That is why we are at a 3 percent default rate.

And, just because we consider the ability to repay does not mean it is a guarantee that the student is more likely to repay at the very end. That helps quite a bit. So, 6 months after graduation, or 6 months after one is no longer a full-time student, we give them 6 months' grace period. Hopefully, they will start paying back after that. If they cannot, we can go into a 6-month forbearance. So, a student who is having trouble maybe finding a good paying job, cannot pay back their loan, we give them an additional 6 months, and then we work with the OCC, with safety and soundness guidance, to ensure we are adhering to that safety and soundness and helping out the student. There is nothing more sacred for us than making sure our students, especially so early in their career, can repay their loan.

Senator CRAPO. Thank you. And, in your testimony, you discussed the Department of Education's new rulemaking dealing with student loans and the disbursement process. It has been mentioned several times here today. I am concerned that the Department has not worked through all of the compliance challenges for banks and supervision challenges for banking regulators. Can you share with us in a little more detail how the Department's rule as it is currently proposed would impact student bank accounts and what kind of compliance challenges would be introduced for banks.

Mr. HUNT. Well, if the Department of Education goes down the path where I think it may be going, there will not be much concern for us on the regulatory structure because I think most of our banks would exit. Right now, the Department of Education want to apply rules and requirements of a cash management program to banks and students that have nothing to do with Title 4 disbursement. It is apples and oranges. So, I am afraid that is the direction they are going.

We negotiated in good faith, with a lot of other consumer groups, to come to a consensus. Quite frankly, I thought there was going to be consensus until the very end and they did not do it. So, we are hoping they will have common sense. They want to apply the same rules and regulations to campus affiliations that have nothing to do with Title 4.

Senator CRAPO. According to one measure—and, again, Mr. Hunt, according to one measure—a report, actually, by MeasureOne, a private research firm, substantial loan performance differences exist between the Federal and private loans, and I think you mentioned that in your testimony, as well. According to the numbers I have, private student loan borrowers only default in the low single digits, I think you said 3 percent——

Mr. HUNT. Correct.

Senator CRAPO. And, the number I had here for Federal loans is close to 20 percent. I think you said 14 percent. But, can you describe some of the features of the—you already did describe some of the features of the private student loan system. Can you explain why that difference exists. What is it about the Federal loans that generates such a higher statistic?

Mr. HUNT. Sure, Senator. Actually, I think it is a tale of two cities. Our default rate is going down. It was 3.13 percent last year and it is down to less than 3 percent, at 2.89. I think the biggest difference is the ability to repay. I think many of our Federal programs do not take into consideration the borrower's ability to repay after graduation. There are no underwriting standards on Federal loans, while on the private side there are extensive underwriting standards. There is nothing worse we can do than give someone a loan they cannot repay. That is something actually Raj Date of the CFPB once told me, that he would never even consider giving someone a loan unless we thought they could repay the loan.

And, you mentioned the number 20 percent. There are some people who are estimating the actual default rate on the Federal side will be as high as 40 percent when you look at the IBR forgiveness that will happen down the road.

Senator CRAPO. Thank you, Mr. Chair.

Chairman JOHNSON. Senator Reed.

Senator REED. Thank you very much, Mr. Chairman.

We are talking about these bank products that essentially are used to take Federal grants and loans and pay tuition, but then the excess is moved into a banking account. And, in your testimony, Ms. Lindstrom, you indicate that there are some arrangements between banks and colleges that appear to be detrimental to students. Is that fair?

Ms. LINDSTROM. That is right. Yes. You know, on a college campus where students are a captive audience and a bank is getting an exclusive deal, that deal should actually be far superior for the students who are exposed to that deal and being marketed to than what is available to them on the open market. But, in fact, that is not the case. In quite a few instances, the deals that students are driven into are equal to or, in some cases, worse than what is available right off campus. And, obviously, we think that that is a huge problem.

The reality is that student aid is ending up in all types of bank and financial firm accounts that are offered to students on campus. So, the mainstream banking industry, during the negotiations with the department of rulemaking [sic] were touting figures of between 20 to 40 percent of students at the places where they had deals with the campus were taking up those accounts. Seven out of ten college students these days are graduating with student loan debt. It is obvious that aid is ending up in those accounts as well as the others, and, therefore, the Department is right on point in terms of extending its protections to students in all the various accounts that are there.

Senator REED. Is not the solution—at least in concept—to require the school, who is the intermediary, to act as a fiduciary for the student, that——

Ms. LINDSTROM. Absolutely.

Senator REED. ——they would be required, because they are dispensing Federal funds, to ensure that they do so for the benefit of the student, and if there is an arrangement with a financial institution, it benefits the student——

Ms. LINDSTROM. That it should benefit, and they should act in the best interest of the students. Actually, that is a criterion that was put into place after the debate over the aggressive private student loan marketing tactics that were in effect previous to the credit crisis, and that was put into place there and it has really helped make the marketplace more fair on campus for students when it comes to steering that was occurring, steering students into those private student loan products. And, we would be thrilled if something similar were in place for students when it comes to campus bank accounts and campus debit cards.

Senator REED. Mr. Kocer, you are on campus. Do you think that you should act as a fiduciary for the students?

Mr. KOCER. All I can comment is our experience at Mount Marty College and our colleagues in South Dakota, there are no arrangements that I know of with any of our colleagues. All of our disbursements are by check or direct deposit, and so I cannot comment on anything as far as arrangements——

Senator REED. Well, that seems to be sort of a sensible approach. I would guess it would be direct deposits to the bank where the student indicates, correct?

Mr. KOCER. That is correct.

Senator REED. So——

Mr. KOCER. The student has a choice of giving us the bank account to deposit into their account.

Senator REED. So, the choice is either let the student decide or, if you are deciding for the student, you have to do it in the best interest of the student. That seems to make sense.

Mr. Hunt, does that make sense?

Mr. HUNT. Sure. Actually, the student does have options. When the student has a disbursement measure, they can choose one of three things. They can go to the bank that has a relationship. They can go to their own institution, wherever that institution is. Or, they can simply check the box and say, I would rather have a check sent to my mailing address. So, there are many choices. All of these campus affiliation products are optional for the student. The student does not have to go to the campus affiliated institution. It is certainly their choice. We think this has provided safe, transparent access for funds for everybody.

Senator REED. Ms. Lindstrom, I think in the comments, some of these choices are harder than others, it seems, on campus. Can you elaborate, because it—in fact, there is a suggestion that there are some very preferential deals between financial institutions and the campus which are giving the campus an incentive, and they use the incentive to put people in these accounts. Is that—is there data there?

Ms. LINDSTROM. Yes. Yes. So, as I mentioned, the Consumer Financial Protection Bureau has actually gathered quite a few contracts and taken a look at what is in those contracts, and there are some reimbursements that schools are getting, essentially a bounty per student that takes up the account. So, then, the student—or the school—has an interest in helping to steer students into those accounts, and obviously, those are written into the contracts deliberately. Yes. So, there is that component, absolutely.

And then in terms of how that faces, or interfaces with the student consumer, as I mentioned in my previous testimony, if you are premailed a card when you have not even made a choice yet and it has got the campus logo on it and the letter is telling you that you should do this right now as a function of receiving your financial aid refund, of course, you are going to log on to the computer and get started enrolling. And, that is in some models where the rubber hits the road.

So, when students actually log onto that screen, it is a screen that is designed by the industry. They are making the choice on the industry Web page, not on the campus or the bursar Web site. The choice to opt into the industry or the campus sponsored account is more prevalent and more prominent and written in a way that, again, steers you to that choice. You might have to click through four or five or six screens to make the choice to steer the aid into your own bank account.

In some instances, you cannot actually make that choice online. You actually have to snail mail or fax information about your own bank account in order to get your aid steered in that direction. So, in fact, it is harder and there are barriers that are set up, and as a result, students are compelled into this campus sponsored choice.

Senator REED. Thank you. My time has expired. Thank you.

Chairman JOHNSON. Senator Heller.

Senator HELLER. Mr. Chairman, thank you, and to the Ranking Member, for having this hearing today, and also to our witnesses that are also here. Thanks for taking time and enlightening us on this particular issue.

I have probably a better understanding, for all the wrong reasons, on this particular issue. I have four children. They are either attending school or have just graduated from college, and so I have got a pretty good idea firsthand of the financial burdens that these students are facing, and on top of that, the difficult job market that our youth are currently facing. I think it is a—we do have two issues here, and that is, obviously, the financial burden of student loans, but also a jobless recovery over the last 5 or 6 years.

If you talk to some of these students, as I have, their friends and my own children and those back in the State of Nevada, they will tell you, you want to solve this problem, get me a job. And, they said, we can solve the burden of our loans if there were jobs created. And, they are very disappointed that this Congress—and they keep asking, when is this Congress going to do something that will help spur this economy and create the jobs necessary so that these young men and women can go into society and take care of themselves. But, obviously, this is a hearing only about student loans, so we will keep it in that direction.

I do not know if this was mentioned—I am sorry I missed the opening statements—but the theme of Know Before You Owe, the initiatives. Mr. Hunt, could you expand on what the private sector is doing with this initiative.

Mr. HUNT. Sure. The private student loan process is like a mortgage. You sit down with the said lender and you fill out an application providing your assets, your liabilities, your income and so forth. If it is approved, it is then sent to the financial institution. The financial institution takes a look at your request, takes a look at the assistance you may be receiving from the Federal Government compares it to the cost of education at that specific university, and then tells the lender, the bank, here is the amount of money this person should receive. It is the ability to repay and it has been very, very successful.

And, if I may just take a moment, Senator, to respond to just a couple of things Ms. Lindstrom said about the campus affiliation. Her report of 2 years ago was very good in the fact that it identified a single bad actor in the industry. That bad actor had enforcement action from the FDIC and we supported every single bit of that enforcement action.

I would tell you, these campus products are very popular, very low complaint rates received by the CFPB. They help stunt the tremendous growth of tuition. It helps to retain and recruit faculty. Many institutions provide scholarships based on this arrangement we have. Many of the banks hire interns from that university if they have an alliance, as well. And, I think most importantly, they provide financial literacy on campus to those students. So, it provides safe access to funds. It has been very well received from students and from institutions.

And, I assure you, Senator, we have a lot of regulators in our banks. If they thought we were unfair, deceptive, or abusive, they would have no hesitation calling us to the mat like the FDIC did with the one bad player.

Senator HELLER. Mr. Hunt, in your understanding of Know Before You Owe, do private lenders work with these students and share with them what alternative financing may be available outside of that institution, like Pell Grants and those kind of issues?

Mr. HUNT. Sir, not only do we want to, we have to. It is required by law. At three different steps throughout the private loan application and disbursement process, we have to provide disclosures to borrowers. There is no question there are some benefits, obviously, to having Federal assistance before you have private assistance.

Then, I think, after you exhaust some of the private matters, then you should go to a private entity to do that. Most students do go to the Federal Government assistance first before they come back to the private. But, we have to. We want to.

We work with the students throughout, because you have to remember, Senator, we have relationships already, usually with their parents, and 97 percent of applications are cosigned by parents or another family member. So, it is a family generational thing. It is not just the first time we are meeting the student.

Senator HELLER. In this jobless recovery, if a student is having a repayment problem, how do you work with them?

Mr. HUNT. Several opportunities, Senator. The last thing we want to do is have someone's credit rating destroyed at the very beginning of their career. We start notifying them months ahead of time when their first payment is due. Then we work with them in case they have hardship, undue hardship especially, do not have the high-paying job, to either extend their payments, refinance their payments, either one.

Senator HELLER. Give me one more time—you may have mentioned this—what is the average complaint rate for private loans?

Mr. HUNT. Well, the CFPB, as you well know, and that is a whole different subject on my plate, they receive complaints from the public and then they disperse them to the public without verifying whether the complaints are actually valid, whether they are true or not, and then it is up to us to disseminate whether it is true or not. But, even if you were to take every single complaint as valid, if you look at the total number of loans we produce, 8.5 million, there were 2,600 complaints about student lending in general. That equates to 0.03, three-one-hundredths of 1 percent, Senator.

Senator HELLER. All right. Mr. Chairman, thank you.

Chairman JOHNSON. Senator Warner.

Senator WARNER. Thank you, Mr. Chairman. I appreciate you and the Ranking Member holding this hearing.

A couple of opening comments and then I want to make a few advertisements for some solutions and get some response from the panel and maybe again alert my colleagues to some ideas.

First, I hear more about student debt around Virginia than I do about Obamacare. People are concerned. It is raised everywhere. We all know the numbers. Mr. Bergeron's comments, I supported Senator Warren's approach on refinancing. If we cannot get that, we need to figure out some other option on refinancing and recognize the combination between the Federal and the private side that is going to have to come together.

Mr. Kocer mentioned something, and Senator Heller mentioned Know Before You Owe. I actually think long before you get Know Before You Owe, we ought to be doing something called Know Before You Go, which is a bill that Senators Wyden and Rubio and I have that would basically build on your idea, Mr. Kocer, of we ought to have a common, easily accessible Web site, not just in terms of student debt, but in terms of all the choices a parent or a student makes before they go to college—retention rates, graduation rates, if you choose a field, as one of my daughters did, in art history—God bless her—what is your chance of getting a job in that field——

[Laughter.]

Senator WARNER. And, we have got a Zillow Web site on real estate. Why can we not create the same for folks making, next to purchasing a home, their most expensive choice they are going to make, the cost of higher education? And, I would include 4-year, 2-year, trade schools, as well. And, so, I wholeheartedly endorse your idea. And, the remarkable thing is, we do not even have to create any new reporting requirements. We have all this data.

And, again, some of the conversation between Ms. Lindstrom and Mr. Hunt, and I do believe we have got some legislation on prepaid credit cards that, I think, would help clear up some of these mistakes, but this Know Before You Go, one option.

Second, and again, apologies to the panel—I am going to take their all nods on Know Before You Go—Mr. Bergeron, I am going to take all your nods as that is a good idea. You are going to get to weigh in on the second one.

There are times when I kind of scratch my head, when there seems like there are certain kind of partial no-brainer solutions that still are not law, and let me point out one right now. And, this is not a full silver bullet to our problems of increasing student debt. But, current law allows an employer to take up to $5,000 of an employee's salary and directly apply it to tuition. You know, we all hear about employers who say, you know, come work with us. You are going to get a Master's. We are going to help pay for it.

Senator Thune and I have said, well, why not take that same concept on the question of student debt. Allow up to $5,000 of a student, or a young person, or a not-so-young person's payment and have that go directly against the debt. Obviously, a great retention tool for the employer. The young employee could opt in or out of this. But, obviously, the employee would receive the benefit of having this money going pretax against the debt.

To me, it seems like a no-brainer. Is there any sense from the panel of whether you would think—and, hopefully, relatively short answers on this—whether this makes sense or not?

Mr. BERGERON. So, let me just agree with you totally on this issue of the Know Before You Go. One of the things I did before I joined——

Senator WARNER. Get to the second part, too——

Mr. BERGERON. I will——

Senator WARNER. ——because I have got one more commercial to make before I am done in a minute and 18.

Mr. BERGERON. So, I will do it real fast. I really love the Know Before You Go, but I think there is something that employers should be doing, and whether it is a change in the tax code to permit it or employers just doing it, just like Starbucks has partnered with ASU. There is no reason an employer could not do exactly what you want to do today.

Senator WARNER. My understanding is there are preclusions that would allow them to have that apply directly pretax——

Mr. BERGERON. Pretax, yes. You would have to change the tax code. But, I think it is a great idea.

Senator WARNER. Can we—I will settle for a "yes."

Ms. LINDSTROM. Yes.

Mr. KOCER. Yes.

Mr. HUNT. Anything you can do to help the student would be terrific.

Senator WARNER. Right, and it is a retention tool for an employer. A student or young person, not so young, necessarily, with some of these debt burdens, makes sense.

Final, and it has been touched upon, income-based repayment. Senator Rubio and I have an approach that would say—we have got that out there as an option right now. It is cumbersome, complicated. Why not allow income-based repayment to become the top default mechanism, allowing, again, a student to withdraw if he or she chooses not to, but would that not provide more flexibility to folks to have the kind of career choices that otherwise are being precluded? I know my time has expired.

Mr. BERGERON. Yes. I absolutely agree that we should have that as the default option, as I indicated in my testimony.

Ms. LINDSTROM. I think we would prefer ensuring that students go into the—or borrowers move right into the repayment plan that is going to keep their costs as low as possible, and IBR does not always work out that way for borrowers, and, therefore, I do not think that IBR as the default is necessarily the right thing.

However, for borrowers who are in delinquency and have been going on in delinquency for 3 months, 6 months, I do believe that some kind of automatic move into IBR makes sense for those borrowers to help them protect their credit and get into something that is clearly going to be more manageable than unchecked delinquency.

Mr. KOCER. I agree with that response, too. It is not always the most advantageous for students. It is good to see which program would be best for them. But, it is a good back-up for, if they are going to delinquency, to get them in a program that they can better afford to spend.

Mr. HUNT. IBR—on the Federal side. It is not on the private lending side. We have our own options, as well. But, anything you can do to reduce the debt on the Federal side is welcome.

Senator WARNER. My time has gone on, but I would just say, Mr. Chairman, there are a lot of folks who fall into default because of if you take that straight 10-year payment, your payments are so high coming out of school, and Income-Based Repayment will give a lot more flexibility. Thank you, Mr. Chairman.

Chairman JOHNSON. Senator Warren.

Senator WARREN. Thank you, Mr. Chairman.

Borrowers who are in serious financial trouble, either because they have lost a job, they have lost a spouse, they have had serious medical problems, can get a fresh start on pretty much every kind of debt by declaring bankruptcy. They can deal with credit card debt. They can deal with mortgages, with payday loans. But, student loans are treated differently. There is, essentially, no discharge, no matter how much trouble you are in or why you are in trouble.

Federal student loans have been excluded from bankruptcy since 1998, and in 2005, the banks successfully lobbied Congress to end bankruptcy protection for private student loans, as well. Now, the

Federal Government at least offers Federal borrowers programs for loan modifications, for default rehabilitation, and for Income-Based Repayment, as we were just talking about, that at least give people some chance to get back on their feet. Look, it is nothing like a fresh start in bankruptcy, and the Federal Government is still making huge profits off these loans, but at least it is something.

Banks, by comparison, get the benefits of the bankruptcy exclusion and do not offer much of anything in exchange to help struggling borrowers. So, last summer, the Federal regulators, including the FDIC, the OCC, and the Federal Reserve, made it crystal clear that private student lenders could offer loan modifications, like reduced interest rates, to struggling borrowers without any penalty. But, according to the Consumer Financial Protection Bureau, banks still, effectively, are not offering that help.

So, what is the impact of that? Well, just 3 days ago, CNN published a story that gave an idea. It was a story about a woman who died, leaving her parents to care for three small children and also leaving them with $100,000 in student loan debt that the couple had cosigned. I think I just heard Mr. Hunt say that the private student loans have about a 97 percent cosigning rate. So, the grandparents of these little children contacted the private lenders, but they could not get much help to manage the huge monthly payments. The couple considered bankruptcy over their daughter's student loan debt, only to discover that bankruptcy is not an option to them.

So, here is my question. If struggling borrowers cannot discharge their loans in bankruptcy, and if your banks will not give them loan modifications, Mr. Hunt, what are they supposed to do?

Mr. HUNT. So, Senator Warren, thank you very much for the question. We share the same concern you do, is making sure that we do everything we can to make sure that students' debt is paid off in a timely manner, especially when you have life circumstances that arise. A very tragic incident that happened. I saw that on CNN and also read the extensive report by Senator Reed on Christopher's Law.

I do not agree with you when you say there are not many options for people to refinance. Citizens Bank, which has a huge presence in Massachusetts, headquartered in Rhode Island, does offer now refinancing——

Senator WARREN. Now, wait, wait, wait. Let us just be careful here when we are talking about refinancing.

Mr. HUNT. Sure.

Senator WARREN. We are not talking about performing loans and you like to reach out to your customers and say, have we got a deal for you. We will lend you some more money. Here is refinance. We are going to change your interest rates.

What I am talking about are loan modifications that reduce the interest rate, that forgive interest, that reduce principal. Do you have any data suggesting that the banks are doing this, because Consumer Financial Protection Bureau says they are not.

Mr. HUNT. Well, I think it is very important, Senator, that when a person does restructure their loan for a lower interest rate, it is loan modification and it is refinancing——

Senator WARREN. So, you are——

Mr. HUNT. In Massachusetts, there is a $126 per month savings for your constituents, and in Rhode Island, it is $149, just by Citizens Bank——

Senator WARREN. So——

Mr. HUNT. ——doing a refinancing——

Senator WARREN. So, that is my question, again, Mr. Hunt.

Mr. HUNT. Yes.

Senator WARREN. Are you telling me that all banks today in America, or even a majority—do you have some data to suggest how many are offering loan modifications for student borrowers that will reduce interest rate or will reduce principal for them? Do you have some data on that?

Mr. HUNT. I will tell you, when it comes to refinancing, the actual amount of the interest rate, it is discovered. Wells Fargo—Wells Fargo——

Senator WARREN. I am sorry——

Mr. HUNT. ——has been doing this for 10 years——

Senator WARREN. The question was, do you have any data to suggest that the banks are offering the kinds of loan modifications that will help people who are in financial trouble get a chance to get back on their feet? After all, Mr. Hunt, the banks lobbied to get nondischargeability in bankruptcy. The question I started with here is what are people supposed to do? What is this family supposed to do that now has three children to take care of and $100,000 in nondischargeable student loan debt from a child who died?

Mr. HUNT. So, Senator, thank you. Two things. There is now loan forgiveness for a student who passes away. Many of our banks are now formalizing that into their contract. I know one is——

Senator WARREN. I am sorry. You are telling me that this is now available from all banks, that there is loan forgiveness, and this couple can take advantage of this loan forgiveness since their daughter died? I had not heard this.

Mr. HUNT. That is mostly right.

Senator WARREN. Is this right?

Mr. HUNT. That is mostly right.

Senator WARREN. I do not understand what mostly right means——

Mr. HUNT. And I will let you know——

Senator WARREN. Is it available or not?

Mr. HUNT. Not all banks. There are many more banks that are giving loan forgiveness throughout the country.

Senator WARREN. What number is "many more"? More than one——

Mr. HUNT. I would say right now, Senator——

Senator WARREN. More than zero?

Mr. HUNT. Yes, ma'am. There are more than zero. In fact, I know of about four, at least four that are doing it right now.

Senator WARREN. Four out of 7,000?

Mr. HUNT. Well, not all 6,700 banks provide student lending, and we do not represent all 6,700. I will tell you, one large institution since 2011 has forgiven $26.8 million because the student, unfortunately, passed away. I think you are going to see more of our banks formalize that into their contract. When a student does pass away——

Senator WARREN. And when it goes——

Mr. HUNT. ——they are going to start forgiving——

Senator WARREN. Thank you, Mr. Hunt——

Mr. HUNT. ——those loans more and more.

Senator WARREN. And when it goes from four to eight, I am sure you will announce that you have seen a hundred percent increase.

Mr. HUNT. Well, keep in mind, Senator, you only have about eight banks that dominate the market. So, we are making progress. A lot of these banks do it by a case-by-case scenario. There is nothing worse than the tragic accident that happened.

Senator WARREN. Yes, actually, there is something worse, and that is when something like this happens and the family is left with $100,000 in debt and three orphans to take care of. That is worse. So——

Mr. HUNT. And I am hoping that bank forgives that loan.

Senator WARREN. Well, I am hoping that bank will forgive that loan, too.

Mr. HUNT. Sure.

Senator WARREN. So far, what that bank has said is no. The banks have not forgiven those loans. They have not provided adequate relief to this family, and I do not know how many other families are in those circumstances.

Thank you, Mr. Chairman.

You know, there really is no substitute for bankruptcy protection. But, the banks went out and lobbied to make sure that they were going to be exempt from the bankruptcy laws, and now they will not even provide the modest relief that is provided on Federal loans for people who end up in terrible financial circumstances. I think this is wrong.

Chairman JOHNSON. Senator Heitkamp.

Senator HEITKAMP. Thank you, Mr. Chairman.

I want to kind of begin with a discussion about the baseline problem, which, to me, is that we do not have a financially literate population, especially among youth, and a lot of what we are talking about today really requires a level of sophistication in terms of understanding the obligations, understanding time value of money, understanding what compound interest can do to you long term, and making sure that they are in the best position. The first line of defense to helping a student is the student themselves and the student's family.

And, so, I have some questions for Ms. Lindstrom. Number one, when you looked at this whole report, you talked about transparency, and I could not agree more, and I think Senator Warner made a great point about let us let people know on the front end, even beyond student debt.

But, what recommendations would you have for us in terms of providing greater transparency on all of these financial transactions, not just debit cards, but student loans in general so that we have more truth in lending, if I can kind of put it that way.

Ms. LINDSTROM. Well, I mean, we are also supportive of the Know Before You Owe provisions that have been discussed. So, in that regard, I think that would be a great start.

Senator HEITKAMP. But, would you not agree that sometimes students make some pretty bad decisions, even if they have access to all that information?

Ms. LINDSTROM. Yes. I mean, I do think that financial education plays a role, but it is not the primary way that you are going to clean up or make the marketplace fair for students. I mean, in reality, these are uninformed consumers who are just emerging in the marketplace and they need stronger protections.

Senator HEITKAMP. You know, I am disturbed a little bit by that answer, that it is not the primary way, because we can deal with student loan debt, and we have dealt with mortgage loan debt, and we can deal with credit card debt, but the most important thing that we can do, in my opinion—and I have been in this fight since the bankruptcy days, since I was Attorney General and represented and was responsible for consumer protection——

Ms. LINDSTROM. Mm-hmm.

Senator HEITKAMP. I see over and over again an unwillingness to kind of get the base of information that consumers need to provide themselves with the first line of protection. And, so, I mean, I can appreciate and understand what you are saying, that things can be clouded and masked and we need to take care of that. We need to make sure it is as transparent as what it can.

But, transitioning to maybe a bigger discussion, what are campuses doing? What are student organizations doing? What are you doing on campuses to provide better consumer education to students so they do exercise either the political clout that they have to tell the administration, I want more options, or the wherewithal to make a different choice.

Ms. LINDSTROM. Mm-hmm. Well, yes. So, specifically, we do run financial education campaigns from time to time. We actually are a student-run organization——

Senator HEITKAMP. Yes, I know.

Ms. LINDSTROM. ——so students make those choices. Currently, I do not have anything that we are running right now, but in the past, we have run—previous to the passage of the CARD Act, we ran a big campaign called FEESA, F-E-E-S-A, where students ran a tongue-in-cheek bank marketing campaign on campus. They dressed up like credit card marketers and they gave out free T-shirts and lollipops, et cetera, and consumer education guides for students on how to navigate the credit card deals that were being hocked on campus at the time. So, that is an example of the type of education that we have engaged in.

And, right now, we are considering engaging in an education campaign around keeping your interest low when you get into repayment——

Senator HEITKAMP. I would just suggest that on the University of North Dakota, they have absolutely created within their Student Financial Office a consumer protection kind of division with consumer education, you know, trying to figure out debt.

But, I have one other question for you. As you look at this, and as you look at not only Federal Government responding but the State governments responding, have you seen any States pass any kind of laws that you think provide a pretty good example of the right kind of protection for consumers?

Ms. LINDSTROM. Right now, the State of California has been considering legislation in the campus banking arena to provide more disclosures for students up front, as has the State of Oregon. Neither of those have actually passed, but I know that those have been—I have spoken to legislators at the State level who are considering those types of things.

Senator HEITKAMP. The example that I have is "no use" fees. There are a number of States that do not allow "no use" fees. I think North Dakota is one of them. I mean, you cannot discount from the card if you do not use the card.

And, so, these are the kinds of things that I think we need to have a broader understanding, because way too often here, we think that the only people who are concerned about these issues in the U.S. Congress or the Federal Government or a Federal agency, when, in fact, there is a whole campus involvement, State law involvement, local State regulatory involvement. And, so, I think we need to have a better understanding of what the whole effort is so that we can continue to provide students with the opportunity to seek other—you know, a broad array of funding options, but also the opportunity to make choices and the education to help them make good choices.

So, thank you, Mr. Chairman.

Chairman JOHNSON. Senator Manchin.

Senator MANCHIN. I want to follow up on what Senator Heitkamp, because, as usual, she and I are on the same wavelength here. I just want to read to you—and you all can then tell me if you agree or not—but, this is the information I received. As of the fourth quarter of 2012, nearly half of the 25-year-old age group has student debt, and overall student debt levels tripled between 2004 and 2012. Further, nearly one-third of the borrowers in repayment are delinquent on student debt—one-third are delinquent on student debt. And, recent data shows shifting demographics of borrowers, with increasing proportions of borrowers in the 40 to 49 age group, 50 to 59, and 60-plus age groups. Student loan debt has quadrupled between 2003 and 2014, while other forms of nonmortgage debt have decreased or seen little growth during that same period of time. And, it says, during the same period of time, the number of students with student loan debt increased by 70 percent, to almost 40 million individuals, and the average balance per borrower also increased by 70 percent, to nearly $25,000 per borrower.

It seems like there is an awful lot of easy money being pushed in one direction to where you have the best chance of a return. I am just simply looking at it without blinders on. It has got to be the best game in town from the banking standpoint, because, I mean, you can sign them up for life and try to collect that for life and they cannot escape it, if there is any way to collect it.

And I know it is very emotional, and we all are, but I have talked to some of the people at West Virginia University, and they told me, they said, it is a hard time denying anybody. You cannot deny them, and you cannot tell them that they do not need all that money. You can tell them that maybe they—but, we do not have any authority or any law to tell them or advise them. So, they might be getting an apartment they cannot afford, or using the money to buy a car, and using the money for almost everything except their education and then throwing the debt on education. This is what I am being told by the University. And, when they are reaching out, something is wrong. There is a problem.

And, then you look at the statistics. When everything else is going one way, this continues to go up disproportionately to everything else. So, that is why you are seeing an awful lot of movement and pressure on this, and something has to be done.

So, we will start—we can start, Mr. Hunt, with you and go right down the line and see if you all have two sentences on this.

Mr. HUNT. Senator, you are 110 percent correct. Something has to be done about the cost of college, A, number one. If we do not address the cost of college, we are going to be right back here every single year, talking about——

Senator MANCHIN. But, if you are—would you agree that—and I am not being, I mean——

Mr. HUNT. Right.

Senator MANCHIN. ——if it was not for bankers, I would be in trouble, because I borrow. We all borrow. But, the bottom line is, this seems to be pretty lucrative from the banking standpoint.

Mr. HUNT. I do not agree with that.

Senator MANCHIN. OK.

Mr. HUNT. If this was lucrative, we would not have gone from a $24 billion industry to $8 billion, and we would not have had banks exit instead of getting into it. I assure you that if it was lucrative, you would see more banks getting in, not getting out.

Senator MANCHIN. How many——

Mr. HUNT. That is not happening.

Senator MANCHIN. What is your percentage of denials on college loan requests?

Mr. HUNT. Oh, about half.

Senator MANCHIN. You think——

Mr. HUNT. It is hard. It is hard to get a student loan, sir——

Senator MANCHIN. You think you all turn down about 50 percent right now?

Mr. HUNT. That is about right. That is about right.

Senator MANCHIN. And that has been about the same all the way? And if I asked all these——

Mr. HUNT. Probably a little bit higher now than it was——

Senator MANCHIN. If I asked all these students how hard it was, all these students out here, did you have a hard time getting a loan, any of you? If you had a hard time and they turned you down, raise your hand.

OK. One hand went up out of the whole room. So, sir——

Mr. HUNT. I do not know if they are doing private. Look, it is almost impossible not to get a Federal loan.

Senator MANCHIN. It is almost impossible not to get one?

Mr. HUNT. Not to get a Federal loan.

Senator MANCHIN. That is what——

Mr. HUNT. It is hard to get a private student loan. The Federal student loan process——

Senator MANCHIN. A private school loan——

Mr. HUNT. ——has no underwriting. The Federal Government has no underwriting standards.

Senator MANCHIN. Uh-huh.

Mr. HUNT. We have all the underwriting standards.

Senator MANCHIN. OK.

Mr. HUNT. If you get a loan from us, we have a pretty good reasonable expectation you are going to pay it back. That is because you qualify for it.

Senator MANCHIN. OK.

Mr. HUNT. And, you have to keep in mind——

Senator MANCHIN. But, now, the Federal—so, you are saying we are lax on our end.

Mr. HUNT. Absolutely.

Senator MANCHIN. OK.

Mr. HUNT. And, so, there is your cost of college.

Senator MANCHIN. So it is us. We have got to change it.

Mr. HUNT. You have got a higher default rate. You have got a 15 percent default rate. You need to have a serious conversation about the cost of college.

Senator MANCHIN. We have got a 33.

We will go right down. Mr. Kocer, if you——

Mr. KOCER. Just a comment there as far as the Federal loan programs are concerned, is when you are saying to find ways to reduce the amount of borrowing for students who do not really need it, if we, the Financial Aid Administrators——

Senator MANCHIN. I am not—I am just saying that you all can evaluate, is that truly the cost? Is that $1,200-a-month apartment and that $500-a-month car payment, should that be part of your student loan?

Mr. KOCER. No, and it is not.

Senator MANCHIN. OK.

Mr. KOCER. When we figure costs of attendance, we figure out a standard cost that would fit an average person, not students who have borrowed or would borrow above that.

Senator MANCHIN. Can students borrow more than what is—I mean, as long as what they qualify for, can they borrow as much as they qualify for?

Mr. KOCER. They can borrow up to a cost of attendance, but one thing that the Federal Government does not allow schools to do is to lower the amount of Federal loans that we can give students. So, if they are at a low-cost——

Senator MANCHIN. Do you think the Federal Government needs to change the rules of how we do Federal loans?

Mr. KOCER. I think they should give Financial Aid Administrators more control over making situations like that possible. If the student is a part-time student, they may not need to take the full student loan that they are taking out. Or, if they are going to a low-cost institution, they may not need that, even though they can qualify it under the cost of attendance.

Senator MANCHIN. Mr. Chairman, would it be possible to hear the other two, if you do not mind? Is that OK? Thank you, Mr. Chairman.

Ma'am, if you would, Ms. Lindstrom.

Ms. LINDSTROM. Yes. I would say that we do not want underwriting criteria for Stafford student loans. Student loans are an access tool. They keep the doors of college open for everybody——

Senator MANCHIN. So, what you are saying——

Ms. LINDSTROM. ——regardless of your background.

Senator MANCHIN. ——is you do not think there should be any more Federal rules on that. Just let the good times roll.

Ms. LINDSTROM. Correct, for Stafford student—for undergraduate Stafford loans, we absolutely need to ensure that that stays as aid, student aid to be able to access college. Now, when it comes to Parental Plus Loans, which is another Federal——

Senator MANCHIN. So, you are in disagreement with her completely.

Mr. KOCER. Well, just to give you an example of——

Senator MANCHIN. I am. I am just asking if you are.

[Laughter.]

Mr. KOCER. Well, to give you—yes——

[Laughter.]

Ms. LINDSTROM. Woo-hoo.

Mr. KOCER. To give you an example, if somebody is a half-time student and they stay a half-time student, they will run out of their loan eligibility before they can get a 4-year degree.

Senator MANCHIN. Got you.

Mr. KOCER. And, so you can counsel them and counsel them and counsel them, but if they can get the money before they can achieve that degree, then they will have——

Senator MANCHIN. We are getting somewhere——

Mr. KOCER. ——private loan——

Senator MANCHIN. OK. And, I enjoy your passion. I really do.

[Laughter.]

Ms. LINDSTROM. I enjoy yours.

[Laughter.]

Ms. LINDSTROM. So, at any rate, that is how I would view that. I think when it comes to private student loans, I mean, the reality is that complaints are on the rise, absolutely, and thank goodness, private student loan consumers have a place to complain. The market is expanding once again. Previous to the credit crisis, there were all sorts of collusion and aggressive marketing tactics and steering occurring on college campuses. There is absolutely no indication that that—well, some of those problems have been solved. Others have not.

We should be making sure that there is a bankruptcy provision available for private student loan borrowers. We should be making sure that private student loan——

Senator MANCHIN. Well, if we do that——

Ms. LINDSTROM. ——certification——

Senator MANCHIN. ——you would agree that we are going to have to change the rules a little bit differently than what they are——

Ms. LINDSTROM. For private student loan borrowers.

Senator MANCHIN. I am saying for the Stafford, too. If you are going to be able to use bankruptcy to not pay your Stafford loan back, then you have got to make sure——

Ms. LINDSTROM. I am sorry. For private student—so, I, actually, I am talking about the private student loan product and not the Federal student loan product. So, I do think——

Senator MANCHIN. Well, the Federal, I mean, it is your tax dollars. I do not care how they come. We are still spending your money or giving it away. So, as an investor, you would want to make sure you are protected the best you can. So, if you are going to let me escape because of bankruptcy, but you are going to make sure I am not a worthy borrower, but you want that to be open, then you are saying you want the Federal Government and the taxpayers to pick up a—now they going to pick up a great loss ratio.

You believe it should be supplemented. I understand. I think I know where you are coming from, and we have a lot of our members that feel the same.

Ms. LINDSTROM. I was making the point around the private student loan product, in particular——

Senator MANCHIN. OK. If I can——

Ms. LINDSTROM. ——completely separate from the Federal student loan product.

Senator MANCHIN. ——I want to give Mr. Bergeron just a little bit of an opportunity. I am sorry.

Mr. BERGERON. Thank you, Senator. I want to go back to the point that Senator Warner was making earlier, that it is really important for us to do a much better job helping students——

Senator MANCHIN. Right.

Mr. BERGERON. ——as they are leaving high school and make decisions about where to go to college so that they take cost into consideration as they do that—cost, graduation rates. When I worked for the administration, we did a College Scorecard, which made sure that those pieces of information, as well as the default and loan burden, were taken into account.

But, I do think on this issue of bankruptcy protection, we at the Center for American Progress wrote a paper where we said some Federal student loans should be dischargeable in bankruptcy, but they are different—they are very specific, where the economy changes and what people are prepared for, those jobs disappear because of broader economic changes. You know, I would use the example of closed captioning, real-time writing, where, at some point, technology is going to just overwhelm that.

So, I think that there is a limited dischargeability in bankruptcy that should be applied to Federal loans, but I also think that private student loans should offer the kinds of protections that the Federal programs do in order to get that bankruptcy protection, and I think there are commercial products that could be developed that would meet that test, and, so, it would address the concerns that——

Senator MANCHIN. Let me——

Mr. BERGERON. ——that Senator Warner was raising—Warren was raising earlier today.

Senator MANCHIN. The Chairman has been so kind here. Let me just make sure that—we know that education is the great equalizer. It is the thing that has made this country what it is today and it is the thing that will continue to keep us the country that we should be, as long as we have the availability of education. So, I think we are all passionate about that.

The numbers are going the wrong direction. You all saw the problems we had in the student loan, just trying to get it back down to the 3.8 and trying to stay within market rates and things of this sort.

We are going to have to get all of you together, even though you might disagree philosophically on certain parts, but how do we keep college affordable, but also the risks that will be taken and who is going to underwrite it, and how do we do it? By getting kids more involved in the educational understanding of what their responsibilities are.

And, with that, Mr. Chairman, thank you so much for your time.

Chairman JOHNSON. I want to thank today's witnesses for testifying about these important issues.

This hearing is adjourned.

[Whereupon, at 11:29 a.m., the hearing was adjourned.]

[Prepared statements, responses to written questions, and additional material supplied for the record follow:]

PREPARED STATEMENT OF DAVID A. BERGERON

VICE PRESIDENT FOR POSTSECONDARY EDUCATION POLICY, CENTER FOR AMERICAN PROGRESS

JULY 31, 2014

Mr. Chairman and Members of the Committee, I am David Bergeron, Vice President for Postsecondary Education Policy at the Center for American Progress (CAP). The Center for American Progress is an independent nonpartisan educational institute dedicated to improving the lives of Americans through progressive ideas and action. As progressives, we believe America is a land of boundless opportunity, where people can better themselves, their children, their families, and their communities through education, hard work, and the freedom to climb the ladder of economic mobility. Accessible, affordable, and high-quality postsecondary education empowers people to strive for better economic opportunities.

I am grateful to the Committee for providing me the opportunity to appear today to discuss the financial products, in particular student loans, that are available to students and their families to help pay for college. In a few short weeks, our Nation's nearly 7,400 colleges, universities, and other postsecondary education institutions [1] will welcome more than 21 million students to their campuses [2]; and, unlike just a few short years ago, these campuses are both physical and virtual with 12.5 percent of the Nation's college students enrolled exclusively in online programs. These students will come to the campus concerned not just about whether they can cut it academically but also about how they will pay tuition and fees, buy books, and meet living expenses. They have good reason to be concerned. Although funding for Federal grants and tax benefits has increased, the net tuition and fee costs at our Nation's colleges and universities have increased even more rapidly. At public 4-year colleges and universities, for example, it costs 50 percent more today in real terms than it did in 1994. [3]

The Obama administration, where I served as the acting Assistant Secretary for Postsecondary Education and the Deputy Assistant Secretary for Policy, Planning, and Innovation until last year, has worked with Congress to increase Federal funding for grants for college students from low- and middle-income families, expand higher education tax benefits that help middle-income families, and make student loans more affordable by lowering interest rates and providing repayment options that allow borrowers to repay those loans as a percentage of their after-graduation income. The Obama administration has also worked to expand consumer information tools, like the College Scorecard, to steer prospective college students toward more affordable and productive institutions and make it easier to apply for Federal student aid and repay student loans.

Role of Student Loans in Financing Postsecondary Education

Most of the borrowing for postsecondary education is through one of the Federal student loan programs authorized under title IV of the Higher Education Act of 1965, as amended; and since July 1, 2010, nearly all of those loans have been made directly by the Federal Government under the William D. Ford Federal Direct Loan program. [4] In just the last 7 years, we have seen outstanding student debt grow from $560 billion at the end of 2006 to $1.26 trillion by March 2014. [5] Of the $1.26 trillion in student loans outstanding in March 2014, approximately one trillion was under one of the Federal loan programs.

In the last several decades, it appears that we have optimized the Nation's higher education financing system for debt. Despite the increases in Federal grants and tax

[1] Scott A. Ginder, Janice E. Kelly-Reid, Farrah B. Mann, "Postsecondary Institutions and Cost of Attendance in 2013–14"; "Degrees and Other Awards Conferred, 2012–13"; and "12-Month Enrollment, 2012–13", National Center for Education Statistics, U.S. Department of Education, July 2014, available at *http://nces.ed.gov/pubs2014/2014066.pdf.*

[2] Scott Ginder and Christina Stearns, "Enrollment in Distance Education Courses, by State: Fall 2012", National Center for Education Statistics, U.S. Department of Education, June 2014, available at *http://nces.ed.gov/pubs2014/2014023.pdf.*

[3] Sandy Baum and Jennifer Ma, "Trends in College Pricing 2013", College Board, 2013, available at *http://trends.collegeboard.org/sites/default/files/college-pricing-2013-full-report-140108.pdf.*

[4] Perkins Loans are still being made from institutional revolving funds. In fiscal year 2014, approximately $1 billion of the $101 billion in new Federal student loans were made under the Perkins Loan program. FY2015 Department of Education Justifications of Appropriation Estimates to the Congress, U.S. Department of Education, March 2013, available at *http://www2.ed.gov/about/overview/budget/budget15/justifications/index.html.*

[5] Consumer Credit—G.19, Federal Reserve, May 2014, available at *http://www.federalreserve.gov/releases/g19/current/*.

credits, the number of students that borrow to meet educational expenses have increased as has the amount that each student must borrow. Between 2007–08 and 2011–12, the median amount borrowed by undergraduates completing:

- a bachelor's degree increased from $20,000 to $26,500, or 33 percent, in just 4 years.
- an associate's degree increased from $8,500 to $13,590, or 60 percent, during the same period; and
- a certificate increased from $8,813 to $10,327, or 17 percent.

Borrowing among graduate students has also increased. The median amount borrowed by graduate students completing a degree program increased from $38,000 to $55,600, an increase of 46 percent again in just 4 short years.[6]

As significant as student loan debt is for those who complete postsecondary education, we need to be most concerned about those who leave college with significant amounts of student loan debt but without completing their education. While some of those leaving postsecondary education before completing a degree do so to start a new job or remain in their current job with enhanced skills, many leave simply because they feel they aren't getting what they need out of postsecondary education either because of the quality of the program they are enrolled in or their own lack of preparation. Among apparent drop outs—students that were enrolled between July and December 2011 but did not earn a degree or certificate or re-enroll for the spring term in 2012, nearly half had borrowed with median debt among those who borrowed of $10,000 while 10 percent of borrowers had debt in excess of $33,000.[7]

Private Student Loans

In addition to the Federal loan programs, many students and their families take out private student loans. One of the issues with private student loans is that we lack good data on the scope and condition of the market. Today, our best data on the interaction between Federal and private loans is the National Postsecondary Student Aid Survey (NPSAS). This survey is only conducted every 4 years and does not provide student level information. As a result, unlike Federal student loans where the Government knows exactly who has student loans, how much debt they have incurred, and the repayment status of that debt, the private student loan market is opaque. Even estimates of the magnitude of the amount outstanding private loans vary dramatically—from as low as $80 billion to a high as $140 billion.[8] Better information on private student loans is critical both for policymakers and for borrowers. Senator Shaheen has embraced an idea we advocated in her Simplifying Access to Student Loan Information Act,[9] which calls for the development of a central online portal that would allow students to review all their public and private student loans as well as repayment options in one place, which would in turn help students better manage, understand and repay their debt. Such a system would also allow policymakers to have access to transparent information into the size and health of the private student loan market. Data on this market is critical to understand the impact of student loans on the economy.

The data from the NPSAS paint a troubling picture of the role that private loans play in financing a postsecondary education by increasing the level of debt that student ultimately hold at graduation. For example, among students receiving a bachelor's degree in 2011–12, graduates with both Federal and private loans borrowed an average of $33,600, or 35 percent more than those with just Federal loans who have an average debt of $24,800. Among students receiving a graduate degree in 2011–12, graduates that had both Federal and private loans borrowed an average

[6] Analysis of data from the 2011–12 National Postsecondary Student Aid Survey (NPSAS) by the Center for American Progress (CAP) specifically for this testimony. Information about the National Postsecondary Student Aid Survey can be found at *http://nces.ed.gov/surveys/npsas/*. The CAP analysis was performed using the National Center for Education Statistics Datalab at *http://nces.ed.gov/datalab/*.

[7] Analysis of data from the 2011–12 National Postsecondary Student Aid Survey (NPSAS) by the Center for American Progress (CAP) specifically for this testimony. Information about the National Postsecondary Student Aid Survey can be found at *http://nces.ed.gov/surveys/npsas/*. The CAP analysis was performed using the National Center for Education Statistics Datalab at *http://nces.ed.gov/datalab/*.

[8] Consumer Financial Protection Bureau and U.S. Department of Education, Private Student Loans, August 29, 2012, available at *http://files.consumerfinance.gov/f/201207_cfpb_Reports_Private-Student-Loans.pdf*.

[9] Senator Jeanne Shaheen, "Shaheen Introduces Bill To Help Students Manage Debt", March 11, 2014, available at *http://www.shaheen.senate.gov/news/press/release/?id=bbe0cf00-6d91-4678-8d03-223d4804334f*.

of $68,600, or 61 percent more than those with just Federal loans who averaged $42,500.[10]

Differences in Consumer Protections

There are significant differences in the consumer protections among Federal loans and private student loans. Private student loans typically charge higher, often risk-adjusted, interest rates, require cosigners, and lack many of the consumer protections standard in Federal student loans. Federal student loan borrowers have access to an array of repayment options that include plans that allow them to pay 10 or 15 percent of their discretionary income, which is the amount above a subsistence budget. Private student loans often offer only one repayment plan of fixed term and monthly payments. Federal student loan borrowers are also entitled to deferments and forbearances and the loans are forgiven on the death or total, permanent disability of the borrower. While some private lenders offer borrowers the opportunity to apply for forbearance, additional fees for setting up the forbearance are common. Finally, most Federal loans can also be forgiven after 20 years of repayment under an income-based repayment plan, which can be shortened to 10 years for those working in public service. Although some State loan programs offer targeted loan cancellation for public service, none is a sweeping as that offered by the Federal offer and no private lender offers a formal loan forgiveness program.

What is also concerning is that some private student loans are made directly to students without knowledge or involvement of the institution of higher education. In order to ensure that students first take full advantage of the Federal student financial aid available, the institution must know if the student has applied for and will receive a private loan. For this reason, I believe the proposal put forth by Senator Durbin—along with Senators Harkin and Franken—for the Know Before You Owe Private Student Loan Act of 2013 is particularly important.[11] This bill would require lenders to seek certification of attendance status and cost of attendance before making a private loan and requires that the postsecondary institutions provide this information to the lender. Not only would the certification play an important role when the loan is being originated but it also would provide the opportunity for the institution to do appropriate loan counseling.

As important as it is for the institution to know about a private loan being made to a student, it is equally important to eliminate the potential abuse that could occur if an institution stands to benefit financially from the making of the private loan or the provision of other financial products to students. The Consumer Financial Protection Bureau has been examining the relationships between institutions of higher education and financial products being offered to students. Last December, Richard Cordray, Director of the Consumer Financial Protection Bureau, expressed concerns about some financial institutions making secret payments to institutions of higher education. He called on the financial institutions to voluntarily make those payments public.[12] Senator Harkin, in his discussion draft of a bill to extend and improve the Higher Education Act of 1965[13] has proposed a similar safeguard as a code of conduct that would prohibit an institution or an employee of an institution from profiting from the making of a private student loan or selling other financial product. These safeguards are clearly necessary. Some institutions of higher education have placed their economic interest before those of their students in entering into agreements with vendors to offer financial services and products to them. One glaring recent example is the growing use by institutions of prepaid debit cards to disburse Federal student aid funds. When prepaid debit cards are issued in other contexts, efforts have been made to ensure that consumers have a choice of financial products to minimize the amount of their own wages or benefits needlessly eroded

[10] Analysis of data from the 2011–12 National Postsecondary Student Aid Survey (NPSAS) by the Center for American Progress (CAP) specifically for this testimony. Information about the National Postsecondary Student Aid Survey can be found at *http://nces.ed.gov/surveys/npsas/*. The CAP analysis was performed using the National Center for Education Statistics Datalab at *http://nces.ed.gov/datalab/*.

[11] Senator Richard Durbin, "As Student Loan Debt Surpasses $1 Trillion, Senators Introduce Legislation To Address Crisis", January 23, 2013 available at *http://www.durbin.senate.gov/public/index.cfm/pressreleases?ID=adad47a3-9b82-4c46-b971-57bb9dc11044*.

[12] Rohit Chopra, "Sunshine for Student Financial Products", Consumer Financial Protection Bureau, December 17, 2013, available at *http://www.consumerfinance.gov/blog/sunshine-for-student-financial-products/*.

[13] Senator Tom Harkin, "With Focus on Affordability and Access, HELP Chairman Harkin Unveils Discussion Draft To Reauthorize Higher Education Act", Senate Health, Education, Labor, and Pensions (HELP) Committee, June 25, 2014, available at *http://www.help.senate.gov/newsroom/press/release/?id=5d38939d-4dc5-4ca8-9924-5762c9bb30e7*.

by fees. The same should be true for the students aid dollars, which may be flowing in the form of student loans.

Bankruptcy Protection

Despite the differences between Federal and private loans, they do have one thing in common: generally speaking, neither can be discharged through bankruptcy. Since our Nation's founding, bankruptcy has been a last resort for individuals and businesses facing severe economic hardships in need of a fresh start. Bankruptcy is available for nearly all types of borrowers and types of debt except for student loans and mortgages on a primary residence.

Some members of Congress have proposed legislation that would again permit private student loans to be discharged more readily in bankruptcy, effectively making student loans equal to credit card debt. Not all private loans are bad and not all Federal loans are ultimately good for borrowers. For example, not all Federal loans have the same borrower protections. While income-based repayment options, like Pay As You Earn, often make it easier for borrowers to meet their living expenses and pay off at least a portion of their student loans, parents using PLUS loans to borrow for a child's education are generally excluded from using the income-based repayment benefit. Making student loans dischargeable in bankruptcy is not just an issue for young adults but also of parents. Congress should move to make some student loans dischargeable in bankruptcy. Last year, CAP offered a proposal to reform the bankruptcy treatment of student loans. Specifically, we suggested that only loans with certain characteristics should be protected from discharge in bankruptcy—loans with reasonable interest rates and fees; deferment and forbearance provisions similar to today's Federal loans; access to income-based repayment; and reasonable likelihood of repayment. [14]

Impact of Student Loans on the Economy

Whether we take steps to address the bankruptcy treatment or otherwise improve the terms and conditions under which private student loans are offered, it appears that the record levels of student loan debt may have hampered recovery from the recession, or even long-term growth. [15] As student loan debt rises, young people are more likely to live with their families. A recent Pew Research Center analysis found that 21.6 million young adults were living with their parents in 2012—an increase of 3.1 million since the start of the Great Recession in 2007, which is not accounted for by increased college enrollment. [16] Household formation is critical for economic activity as Moody's Analytics estimates that each new household generates an estimated $145,000 of economic activity. [17] As recently as May, Liberty Street Economics wrote on the impact of student loan debt on home ownership and auto markets. [18] There is also some evidence that high levels of student debt may cause borrowers to delay marriage or having children. [19] Others have offered evidence that the current levels of student loan debt are impacting the creation of small businesses [20] and, although there is not empirical evidence, high levels of student loan

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[14] Joe Valenti and David Bergeron, "How Qualified Student Loans Could Protect Borrowers and Taxpayers", Center for American Progress, August 20, 2013, available at *http://www.americanprogress.org/issues/higher-education/report/2013/08/20/72508/how-qualified-student-loans-could-protect-borrowers-and-taxpayers/*.

[15] Dina ElBoghdady, "Student Debt May Hurt Housing Recovery by Hampering First-Time Buyers", *Washington Post*, February 17, 2014, available at *http://www.washingtonpost.com/business/economy/student-debt-may-hurt-housing-recovery-by-hampering-first-time-buyers/2014/02/17/d90c7c1e-94bf-11e3-83b9-1f024193bb84_story.html.*

[16] Richard Fry, "A Rising Share of Young Adults Live in Their Parents' Home", Pew Research, August 1, 2013, available at *http://www.pewsocialtrends.org/2013/08/01/a-rising-share-of-young-adults-live-in-their-parents-home/*.

[17] Catherine Rampell, "As New Graduates Return To Nest, Economy Also Feels the Pain", *New York Times,* November 16, 2011, available at *http://www.nytimes.com/2011/11/17/business/economy/as-graduates-move-back-home-economy-feels-the-pain.html?—r=1&*.

[18] Meta Brown, Sydnee Caldwell, and Sarah Sutherland, "Young Student Loan Borrowers Remained on the Sidelines of the Housing Market in 2013", *Liberty Street Economics*, Federal Reserve Bank of New York, May 13, 2014, available at *http://libertystreeteconomics.newyorkfed.org/2014/05/just-released-young-student-loan-borrowers-remained-on-the-sidelines-of-the-housing-market-in-2013.html#.U9aIuSbD-70.*

[19] William G. Gale, Benjamin H. Harris, Bryant Renaud, and Katherine Rodihan, "Student Loans Rising: An Overview of Causes, Consequences, and Policy Options", Brookings Institute, May 2014 available at *http://www.brookings.edu/research/papers/2014/05/student-loan-debt-rising-gale-harris.*

[20] Phyllis Korkki, "The Ripple Effects of Rising Student Debt", *New York Times,* May 24, 2014, available at *http://www.nytimes.com/2014/05/25/business/the-ripple-effects-of-rising-student-debt.html.*

debt likely result in delayed retirement savings or lower saving levels overall further damaging long-term financial security.

In analysis CAP did earlier this year, we found that of the $1 trillion in Federal student loans outstanding, only 60 percent of borrowers in repayment were actually making scheduled payments. The remaining 40 percent of borrowers were in deferment, forbearance, or default. As noted above we do not have good data on the condition of private student loans. However, I do not believe that those loans are in a better condition than Federal student loans, which could mean that there is an additional $30 to $80 billion in distressed private loans.

Most troubling for me are borrowers that have both private and Federal student loans. The combination of private and Federal student loans leaves borrowers caught between a rock and a hard place. The private student loan, because it is less flexible, may be more difficult and expensive to pay back, but the consequences for nonpayment of Federal loans are much higher. Borrowers with both types of loans who cannot keep up with payments must choose between falling behind on a high-interest private loan, leading to owing more interest and damaging one's credit, or falling behind on a Federal loan, leading to possible wage garnishment and other penalties.

CAP has strongly advocated for refinancing of student loans to the same low interest rates that apply to other loan products in order to make families more financially secure and stimulate the broader economy. A number of senators have offered proposals for refinancing of both Federal and private student loans including Senator Warren who offered the Bank on Students Emergency Loan Refinancing Act, which is cosponsored by the majority of this Committee. Last month, Senator Warren's bill failed to get the 60 votes needed to advance the legislation, with a 56–38 vote on the Senate floor. I hope that the Senate will reconsider that important legislation again in the fall because refinancing student loans would potentially save borrowers billions, give them the ability to take control of their future and become more financially stable. The money that student loan borrowers would save could be spent and reinvested in the economy. Lowering student loan interest rates to 5 percent would save $14 billion for borrowers and add $21 billion to the economy in the first year alone.[21] Refinancing student loans would be good for young people and their families, allowing as many as 25 million borrowers to make smaller student loan payments.

Some analysts have argued that a typical student loan borrower is no worse off today than a generation ago. These analysts go on to suggest that borrowers struggling with high debt loads is not new and that the percentage of borrowers with high payment-to-income ratios has not increased over the last 20 years and may have declined.[22] However, the analysts discount the significance of one particularly disturbing trend—the lengthening of the time required to repay a student loan from 7.5 years to 13.4 years, an increase of 79 percent, a significant change resulting from the loan consolidation activity that occurred in the early 2000s. The lengthening of the time required to repay a student loan should not be discounted. If it takes more than 13 years after graduating to finish repaying student loans, it certainly impacts a borrower's ability to save for their child's education, buy a home, start a small business, or save for retirement.

Servicing and Debt Collection

Even with good terms and conditions for the Federal student loans, poor servicing of those loans can increase loan delinquencies and defaults. A study of student loan servicing conducted by the Federal Reserve Bank of New York demonstrates that there are significant gaps in the servicing of student loans.[23] The Federal Reserve analysis revealed that most households, even among those with higher levels of student loan literacy, had a poor understanding of the implications of being delinquent

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[21] David Bergeron, Elizabeth Baylor, and Joe Valenti, "Resetting the Trillion-Dollar Student-Loan Debt Problem Center for American Progress", November 21, 2013, available at *http://www.americanprogress.org/issues/higher-education/report/2013/11/21/79821/resetting-the-trillion-dollar-student-loan-debt-problem/*; and Anne Johnson and Tobin Van Ostern, "It's Our Interest: The Need To Reduce Student Loan Interest Rates", Center for American Progress, February 13. 2013, available at *http://cdn.americanprogress.org/wp-content/uploads/2013/02/StudentLoanRefinancing-5.pdf.*

[22] Beth Akers and Matthew M. Chingos, "Is a Student Loan Crisis on the Horizon?", Brown Center on Education Policy at Brookings, June 2014, available at *http://www.brookings.edu//media/research/files/reports/2014/06/24%20student%20loan%20crisis%20akers%20chingos/is%20a%20student%20loan%20crisis%20on%20the%20horizon.pdf.*

[23] Basit Zafar, Zachary Bleemer, Meta Brown, and Wilbert van der Klaauw, "What Americans (Don't) Know About Student Loan Collections", *Liberty Street Economics,* Federal Reserve Bank of New York, June 5, 2014, available at *http://libertystreeteconomics.newyorkfed.org/2014/06/what-americans-dont-know-about-student-loan-collections.html#.U9ZdWCbD-70.*

on student loans. This should not be surprising as there is significant pressure on the Federal Government and private lenders to service as cheaply as possible. Today, the Federal Government spends between $1.67 and $2.22 per month per account on servicing.[24]

Additionally, the current student loan servicing system is a product of regulations that govern the servicing of Federal Family Education Loans (FFEL). These regulations were written in the 1970s to reflect the then existing "best practices" in loan servicing. These regulations became the de facto standard for student loan servicing not just for FFEL but also for private loans. When the Federal Direct Loan Program was implemented, the FFEL servicing regulations became the core of the business rules governing servicing in the new Direct Loan program. During my tenure with the Department of Education, we often discussed the need to update and improve the loan servicing regulations but the loan servicers, having built automated systems to implement those regulations, opposed any effort to update them.

The Department moved from rule-based to performance-based servicing for the Direct Loan Program; the hope at that time was that such a change would improve the quality of service and lead to innovation in the way the Federal student loans are serviced. Unfortunately, other changes to the servicing system have limited the potential impact of this change. When the Health Care and Education Reconciliation Act was enacted, a provision was included that mandated awarding servicing contracts to not-for-profit loan servicers. The not-for-profit loan servicers were guaranteed a specific number of loan accounts to service, which rendered the performance-based elements of the servicing contracts ineffective.

The bottom line is that student loans need better servicing. If a debt is appropriately serviced, the borrower is less likely to become delinquent and default. But we need to remember that there is an entire industry that has grown up around delinquency and default in student loans. Currently, the Department of Education employs 22 private contractors[25] to collect on the more than $35 billion in defaulted student loan debt.[26] Private lenders, guarantee agencies, and institutions also employ private debt collection contractors. A recent audit by the Department of Education's Inspector General found that the Department did not effectively monitor whether the private collection agencies are abiding by the Federal debt collection laws. Given the high stakes associated with Federal student loans, such a lapse is very troubling and suggests that it may be time to fundamentally rethink our student loan strategy. Last December, the Consumer Financial Protection Bureau issued a rule that will allow the agency to supervise nonbank student loan servicers for the first time. I applaud the Bureau's action because it brings needed protections to a financial market that has seen a rise in borrower delinquency in recent years.[27] But what is also necessary is for significant improvements in the servicing of private student loans.

Let me conclude by asking a fundamental question: why, with all the repayment options available to borrowers today, do we still have defaults in the Federal student loan programs? Likely, it is because we have made the system too complex to navigate, we are not doing a good enough job in counseling students before they borrow or when they leave postsecondary education, and we are not servicing the loans well enough.

Ultimately, we need to rethink how we are making and collecting on Federal student loans. Perhaps it is time to consider, as some in Congress and the community have suggested, using the wage withholding system to collect student loans as a way to prevent delinquency and default. Under a wage withholding based student loan collection system, the borrower would tell her employer that she had a student loan. The employer would withhold a student loan payment equal to, for example, 10 percent of the borrower's discretionary income. The employer would send the student payments to the Federal Government along with the income and other taxes withheld. At least quarterly, the employer would provide sufficient information to the Federal Government to reconcile the loan payments for each borrower. Once the

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[24] The Appendix, Budget of the United States Government, Fiscal Year 2015, Office of Management and Budget, Executive Office of the President, March 4, 2014, available at: *http://www.whitehouse.gov/omb/budget/Appendix.*

[25] Patrick J. Howard, "Handling of Borrower Complaints Against Private Collection Agencies", Office of Inspector General, U.S. Department of Education, July 11, 2014, available at: *http://www2.ed.gov/about/offices/list/oig/auditreports/fy2014/a06m0012.pdf.*

[26] The Appendix, Budget of the United States Government, Fiscal Year 2015, Office of Management and Budget, Executive Office of the President, March 4, 2014, available at: *http://www.whitehouse.gov/omb/budget/Appendix.*

[27] CFPB To Oversee Nonbank Student Loan Servicers, Consumer Financial Protection Bureau, December 3, 2013, available at *http://www.consumerfinance.gov/newsroom/cfpb-to-oversee-nonbank-student-loan-servicers/.*

loan is repaid, the Federal Government would refund to the borrower any overpayment that results from the wage withholding. Such as collection system for student loans is not new. Australia and New Zealand have such systems. However, in the United States we should allow the employee to opt out of wage withholding and arrange to pay under an alternative repayment system. This would be similar to the alternative quarterly filling which some taxpayers use today. Implementing a wage withholding based repayment system would result in fewer defaults and less delinquency in the Federal loan programs. Since defaults and delinquency on Federal student loans are extremely harmful to borrowers, and only the debt collection contractors ultimately benefit from defaults, such a new system should be considered. Such an approach would also significantly reduce the cost of servicing. These savings could be passed on to borrowers through lower interest rates or to current students through increased Pell Grants.

Thank you again for the opportunity to appear before you today. I am happy to respond to any questions you have.

PREPARED STATEMENT OF CHRISTINE LINDSTROM

HIGHER EDUCATION PROGRAM DIRECTOR, U.S. PUBLIC INTEREST RESEARCH GROUP

JULY 31, 2014

Thank you Chairman Johnson, Ranking Member Crapo, and other distinguished Senators for giving me this opportunity to speak. My name is Chris Lindstrom, and I am the Higher Education Program Director with the U.S. Public Interest Research Group (U.S. PIRG). U.S. PIRG is a federation of State-based consumer protection groups, which have 75 campus chapters in 20 States across the country. On behalf of those student chapters, our project works to promote affordable and manageable student loan policy, to increase grant aid, and to protect student consumers on campus.

The topic of today's hearing is broad, so I will focus my remarks on issues that U.S. PIRG has been actively tracking and promoting related to the role of financial institutions on campus. Our top priority over the past 2 years has been the debit cards and bank accounts that millions of students are exposed to on campus each term. I will also briefly touch on the private and institutional loans that students may take up to pay for college.

Since 2007, we've worked to ensure that students are protected from the tricks and traps layered into high-cost products like campus credit cards, private student loans, and campus bank accounts and debit cards. Right now, students are being hit with high fees that are hard to avoid as they try to access their Federal aid refunds through campus-sponsored bank accounts and prepaid debit cards. The lowest income students, who receive the most in financial aid, are the prime targets for these products and are the hardest hit. Paying extra fees to access financial aid through a campus-sponsored account, combined with a high student debt burden and other pressing financial concerns such as child care and transportation costs, can overwhelm low income students and cause them to withdraw from post-secondary programs.

We found in our 2012 report, "The Campus Debit Card Trap", that two in five college students in the country are exposed to debit cards on campus that may drive up their costs. Students at some campuses are charged steep and unusual fees to get to their Federal financial aid, including PIN transaction fees at the point of sale and overdraft fees at $37 or more. On the whole, these accounts are not necessarily a better deal for students than what they might find through a bank not affiliated with campus. [1]

Still, industry leading banks and financial firms can see 40 to 75 percent of students on a campus using the campus based products after a few years of marketing. [2] How do they do it? How do they get such high uptake into accounts that are not any better, and in many cases, worse, than what they would get in accounts off campus? How are they profiting?

First, banks and financial firms behind these products often rely on revenue-sharing agreements with campus administrations to gain dominant access to students on campus. Contracts disclosed to the Consumer Financial Protection Bureau, as part of its investigation launched last year include receiving direct payment to use

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[1] Report, "The Campus Debit Card Trap", U.S. Public Interest Research Group Education Fund, May 30, 2012.

[2] Issue Brief, "Perspectives on Financial Products Marketed to College Students", The Consumer Financial Protection Bureau, March 26, 2014.

the school's logo, providing bonuses for recruiting students, and discounted pricing in exchange for marketing access.

Second, they use push marketing and other strategies to steer students into opening up these new accounts over using their existing accounts. Higher One, a prominent financial firm in this market, premails a card to every student on campus, before they have opted in or out. The cards are cobranded with the college logo, giving the impression that the student must open the account.[3]

Once the student logs online to opt in or opt out, Higher One steers folks into their accounts by slowing down their aid disbursements if they make a choice other than Higher One. This makes it unfairly onerous to set up direct deposit to an existing bank account to receive funds.

At another college, bank representatives actually set up tables right outside the student ID office, and pitch students as they apply for their IDs to sign up for a bank account right then and there. These bank accounts can be accessed right through the student ID card. Students can get freebies like bags and tee shirts for signing up.[4]

Finally, the fees can be high, and unusual. Fees on university-sponsored cards include a variety of PIN swipe fees, inactivity fees, overdraft fees, ATM fees and fees to reload prepaid cards. These fees can be hard to avoid—for example, if a merchant only accepts PIN debit, or there is no fee-free ATM available. Additionally, if these fees are being paid out of Federal loan funds, then students are paying interest on these fees for at least a decade.

All campus bank accounts and prepaid card services charge overdrafts. Overdraft coverage is a form of credit, since the financial institution covers the consumer's shortfall and subsequently is repaid the amount extended plus a fee. Some banks engage in the abusive practice of purposefully "reordering" transactions to maximize overdraft fees. In 2012, the FDIC settled a case with Higher One for $11 million dollars over similar claims.[5] Overdraft fees are inconsistent with the Department of Education's existing rules on school-sponsored accounts, which state that schools, and the financial institutions handling financial aid refunds on the school's behalf, cannot market a card or account as credit or convert it to a credit instrument.

Department of Education rules also require that students be provided 'convenient' fee-free ATM access. In practice, such access can be limited. At many community colleges, there is a run on the campus ATM machines on the day that financial aid is disbursed. The machines are cleaned out of cash early so students at the back of the line must go to a foreign ATM machine to access their aid, where they incur fees. Also, machines on campus may be closed for maintenance for days at a time, or be located in buildings that are locked at nights and on weekends.

One argument that is being made in defense of these campus banking products is that too many low income students are not able to acquire a bank account other than on campus, and by controlling their access to campus bank accounts, their access to other beneficial products available in the mainstream financial marketplace is blocked. The CFPB laid this argument to rest at a recent presentation to the U.S. Department of Education. The agency analyzed data from the Federal Deposit Insurance Commission and the Current Population Survey. It found that very few students—less than half a percent—are legitimately unable to secure a bank account. What that means is that a new student on campus doesn't have a bank account because she has chosen not to have one, or hasn't gotten one yet.[6] So, put simply, students do not need campus sponsored bank accounts.

There is a steady drumbeat of evidence that campus-sponsored accounts are a bad deal for students. In the past 2 years, at the request of Senator Dick Durbin (D-IL) and Representative George Miller (D-CA), the CFPB has undertaken an investigation;[7] so has the Department of Education's Inspector General which resulted in a recent report,[8] and finally, the General Accounting Office has recommended

[3] News story, "New Haven's Higher One Faces New Restrictions in Draft Federal Rules", *The New Haven Register,* March 25, 2014.

[4] News Story, "Bank Pays $34 Bounty for New College Customers", ABC News, September 5, 2013.

[5] Press Release, "FDIC Announces Settlements With Higher One, Inc., New Haven, Connecticut, and the Bancorp Bank, Wilmington, Delaware, for Unfair and Deceptive Practices", Federal Deposit Insurance Commission, August 8, 2012.

[6] Issue Brief, "Perspectives on Financial Products Marketed to College Students", The Consumer Financial Protection Bureau, March 26, 2014.

[7] Press Release, "CFPB Launches Inquiry on Campus Financial Products", January 31, 2013.

[8] Report, "Third-Party Servicer Use of Debit Cards To Deliver Title IV Fund", Department of Education Office of the Inspector General, March 10, 2014.

policy changes that would benefit students.[9] There is also a class action lawsuit pending in Connecticut[10] and two major enforcement actions by the FDIC[11] and the Federal Reserve Board[12] with another still in development. The Department of Education is also in the process of updating its rules to address similar concerns.

While these actions are encouraging, I urge you to promote solutions from this chamber as well. Our elected leaders in the Senate can act directly on behalf of students and families shouldering high costs associated with higher education.

I urge you to consider legislation that bans revenue-sharing agreements between colleges and banks or financial firms crafted specifically to offer bank accounts and related banking products to students on campus. The conflict of interest inherent in these agreements is problematic for the student consumer. We've seen this conflict of interest before in the campus marketplace around private student loans and campus credit cards. In fact, both Congress and the Department of Education have acted decisively in recent years to limit push-marketing tactics, revenue sharing, and unfavorable terms on private student loans and credit cards offered on campus. Now is the time to extend similar solutions to campus bank accounts and related products. Such a solution would remove any financial incentive for a college to "monetize" its relationship with a bank in a way that harms students. Specifically, effective legislation would ban banks and financial firms from offering compensation to schools for assisting in the marketing of financial products; and would further require that any financial products recommended by the college to students be in the students' best interests.

Private student loans are another financial product targeting students. While these loans only accounted for seven percent of all educational loans made last year, they are very risky. Private student loans, like credit cards, generally offer variable interest rates that are higher for those borrowers with the least means. Repayment options are also severely limited. While the market for private student loans shrunk due to the financial crisis, it is expanding once again.[13] According to the CFPB, the majority of private student loan borrowers have not maximized their Federal student loans before turning to private loans. I encourage you to consider legislation that will add more checks and balances into the private student loan market, specifically by requiring that all private student loan products must be certified by the student's financial aid office before approval.

In a similar vein, institutional private loans deserve scrutiny. A Senate HELP committee investigation found that half a million students leave their for-profit college without a degree, shouldering high debt levels that are more challenging to manage without credentials.[14] Before the financial crisis, for-profit colleges played the role of financial institution, offering institutional private loans to student recruits on top of their Federal loans. While many of these institutional loan programs have been discontinued, borrowers who are in repayment now carrying these loans are dealing with high costs and little recourse. We urge you to consider offering restitution for these borrowers who are ensnared in these bad loan deals.

PREPARED STATEMENT OF KENNETH KOCER

DIRECTOR OF FINANCIAL ASSISTANCE, MOUNT MARTY COLLEGE, YANKTON, SOUTH DAKOTA, AND PRESIDENT, SOUTH DAKOTA ASSOCIATION OF STUDENT FINANCIAL AID ADMINISTRATORS

JULY 31, 2014

Chairman Johnson, Ranking Member Crapo, and Members of the Committee, thank you for inviting me to testify this morning on the important topic of private education loans. For the past 23 years I have served as Director of Financial Assistance at Mount Marty College in Yankton, South Dakota. I am also the current

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[9] Report, "College Debit Cards: Actions Needed To Address ATM Access, Student Choice, and Transparency", General Accounting Office, February 13, 2014.

[10] Press Release, "Higher One Agrees To Settle Class Action Regarding OneAccount Fees", Tycko and Zavareei, July 23, 2014.

[11] Press Release, "FDIC Announces Settlements With Higher One, Inc., New Haven, Connecticut, and the Bancorp Bank, Wilmington, Delaware, for Unfair and Deceptive Practices", Federal Deposit Insurance Commission, August 8, 2012.

[12] Press Release, Board of Governors of the Federal Reserve System, July 1, 2014.

[13] Report, "Private Loans, Public Complaints: The CFPB's Consumer Complaints Database Gets Real Results for Student Borrowers", U.S. Public Interest Research Group Education Fund, October 24, 2014.

[14] Report, "For Profit Higher Education: The Failure To Safeguard the Federal Investment and Ensure Student Success", Senate Health Education, Labor, and Pensions Committee, July 30, 2012.

president of the South Dakota Association of Student Financial Aid Administrators (SDASFAA). In addition, my institution is also a member of the National Association of Student Financial Aid Administrators (NASFAA), the national association representing financial aid administrators at the Federal level.

At Mount Marty College, we actively promote the Federal student loan programs for students as their first and best option when considering a loan to assist with educational costs, as do many of my colleagues throughout South Dakota. In particular, financial aid administrators counsel students on the many benefits of the Federal student loan program, including the availability of subsidized interest for certain borrowers, options for loan forgiveness, and the multiple generous repayment plans. Beyond these benefits, the Federal Direct Loan program additionally offers: deferment and forbearance options, Federal consolidation opportunities, and in many instances lower interest rates.

Even with students being counseled to utilize (and exhaust) the Federal student loans available to them, some still find that they need additional resources. Private loans can fill the gap in certain cases, by funding a student's educational costs when Federal resources fall short. Institutions in South Dakota generally have a lower tuition rate when compared to other States, yet even we find that some students will need to utilize private education loans. In surveying my colleagues throughout the State, as many as one third of students on some campuses receive private education loans.

I'd like to share with you an example of the "gap" that I described above, that may cause a student to utilize a private student loan in order cover educational costs. Let's say an institution costs $18,000 for tuition, fees, room and board, setting aside for now any indirect costs like books, transportation, and personal costs.

If the student is not Pell Grant eligible, the only guaranteed Federal eligibility the student has as a first year dependent undergraduate student is a direct loan for the amount of $5,500. Using the aforementioned example of our $18,000 school, this leaves over $12,000 which the student would need to find a way to fund. Lacking parental support, this shortfall in Federal loan eligibility leaves the student looking to other options. For this reason private student loans, with proper consumer protections, do fill an important need for some students.

I'd like now to briefly walk you through the processing procedure for private student loans. It begins with the student selecting a private lender they feel best suits their needs. In South Dakota a number of schools provide a site where students can access a "historical" list of private loans that students at that institution have utilized in the past. Importantly, providing a "historical list" of private education loans is different than providing a "preferred lender list," in which case the schools recommend specific private loans to students. A historical list displays features of the different private loan programs, enabling students to make comparisons that hopefully lead to an informed decision. Once a student selects the private loan they wish to borrow, they apply for the loan directly through the private lender, the lender approves the loan, and a certification request is sent to the school. The school reviews the student's educational cost of attendance and the financial aid resources that the student has already received (for example, Federal loans and grants) to determine the amount of the private loan for which the student is eligible.

By involving the school in the private loan certification process, it allows the school to track all borrowing a student is incurring, and counsel the student on the overall amount of their loan debt. From an institutional perspective, we consider this a good practice as it provides us with more information to assist in preventing students from over-borrowing. Through the process of certifying the private loan the school can ensure the student has not borrowed beyond the calculated cost of attendance.

There are quite a few private lending institutions that currently utilize school certification as a prerequisite in determining whether the student is eligible for their private education loan, but lenders are not required to do so.

Having provided some context on private education loans, I'd like to offer the following recommendations to improve the private loan process for all borrowers.

Recommendation 1

Require School Certification for All Private Education Loans

The current private education loan application process should be revised to continue to counter the impact of lender marketing, and to assist in managing student over-borrowing. Replacing student self-certification with full school certification would give institutions the opportunity to ensure that a student is aware of the benefits of Federal loans before the student commits to a potentially less favorable private loan. Additionally, by requiring that an aid administrator review the student's remaining eligibility under cost of attendance limits, we can help reduce unnecessary or inappropriate student borrowing.

Recommendation 2

Provide One Single Web Site Where Students Can See All Their Education Borrowing From Federal, Institutional, and Private Sources

SDASFAA supports NASFAA's recommendation to create a universal loan portal for students.

Congress should mandate the creation of a single web portal where students can easily access information about all of their student loans. This would allow all educational loans from the Federal Government, private lenders, and colleges and universities to be reported to one central database. The creation of such a resource could result from the expansion of the data collected by the National Student Loan Data System (NSLDS).

Students need an accessible "one-stop shop" where they can manage their student loans. Many borrowers have multiple loans with different loan holders that may be in various stages of repayment. Having a central Web site where borrowers could access information about all of their loans would significantly help students as they manage their borrowing and repayment. Under such a scenario, all students would have access to their entire debt portfolio in real time, enabling them to calculate a more accurate monthly repayment amount based on a variety of potential circumstances.

It is critical that students be able to obtain and monitor all of their loan information in one central database, regardless of their loan's origination, rather than having to pull information together in a piecemeal fashion, which may cause important information to fall through the cracks. Currently NSLDS only partially serves this purpose as it includes only some Federal loans, and it does not include health professions loans made through the Department of Health and Human Services (HHS), private loans, or institutional loans. A universal loan portal would capture all of these loans.

Appendix: Example of Certifying a Private Loan Under Calculated Cost of Attendance

The U.S. Department of Education provides schools with "allowable costs" which may be included in a students' educational "cost of attendance." This "cost of attendance" amount is very important as it determines the maximum amount of aid a student may receive and assists in controlling over-borrowing by the student.

The "cost of attendance" includes direct costs the student may incur such as:

- Tuition and Fees
- Room and Board (if on-campus)

But the cost of attendance also includes "indirect costs" a student may incur such as:

- Books and supplies
- Transportation
- Personal expenses

Financial aid offices can also take into account other student costs such as disability expenses, child care and a computer used for the students program of study.

A typical 9 month budget could look something like this:

Tuition/Fees $10,000
Room & Board $6,000
Transportation $2,000
Personal $2,000
Books $1,000
Loan Fees $100
Total $21,100

If the student were receiving the following financial aid for this period:

Pell Grant $5,000
SEOG Grant $1,000
Scholarship $4,000
Perkins Loan $1,000
TEACH Grant $3,000
Direct Sub. $3,500
Direct Unsub. $2,000
Total $19,500

The school is able to determine that the student still has $1,600 of eligibility remaining toward allowable educational costs: $21,100 minus $19,500. If a private loan request for $10,000 comes to the school for certification, the school would only allow $1,600 of that request for the students cost. If, however, the private loan request did not come to the school for certification and instead went directly to the student, the student is in essence borrowing $8,400 above their educational costs. School certification would prevent this.

A SDASFAA member institution recently described a student requesting a $20,000 private student loan. This private loan required school certification. The school denied the private loan, as the student was already receiving financial aid to cover their full educational cost of attendance. As it turned out, the student wanted to buy a car. If this loan had not been certified through the financial aid office, it would have added another $20,000 in student loan debt for an item which was not education related.

Simply put, a private lender that does not require school certification, is awarding the student based on credit-worthiness, but is not taking into account the actual cost of attendance for the student or the resources the student may have already received to meet their cost of attendance.

PREPARED STATEMENT OF RICHARD HUNT

PRESIDENT AND CHIEF EXECUTIVE OFFICER, CONSUMER BANKERS ASSOCIATION

JULY 31, 2014

Chairman Johnson, Ranking Member Crapo, and Members of the Committee, thank you for convening today's hearing on financial products for college students. The timing of this hearing could not be better. Families across the country are preparing to send students off to school over the next few weeks and, while most will have their financing squared away ahead of time, many will make important decisions about how and where to bank once they arrive on campus, therefore the need for safe, regulated, transparent products will never be more important.

The Consumer Bankers Association (CBA) is the trade association for today's leaders in retail banking—financial services geared toward consumers and small businesses. Our mission is to preserve and promote the retail banking industry as it strives to fulfill the financial needs of the American consumer and small businesses. CBA's corporate members (the Nation's largest financial institutions, as well as many regional banks) collectively hold two-thirds of the industry's total assets. Our associate members represent the premier providers of technology and services to banks.

Several CBA members provide student loans and banking services for the 21 million students enrolled in U.S. colleges, as well as their families.[1] We appreciate the opportunity to offer the insights of our consumer-focused banks on these products, services, and their associated marketplaces.

Before addressing the specific issues you asked me to discuss, I think it is critical to acknowledge the real crisis we face today—the rising cost of higher education. Since 1978, tuition and fees at institutions of higher education have grown at more than four times the rate of inflation and even twice the rate of health care costs.[2] If policymakers fail to find ways to make college more affordable, then we are simply addressing the symptoms of a much bigger problem and allowing it to snowball, to the detriment of our Nation's youngest citizens. CBA members strongly believe in the pursuit of higher education, a term which can mean anything from vocational training to graduate work, depending on the student's plans. Continued learning is absolutely critical for economic mobility and the success of our Nation's economy. Despite the rising cost of a diploma, study upon study has shown the return on the college investment remains unparalleled.[3] CBA's members are committed to helping their customers invest in themselves, their families, and ultimately their futures.

Deciding where to attend and how to pay for college are among the most important financial decisions an individual will make. Financial institutions can play a

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[1] U.S. Department of Education, National Center for Education Statistics. (2013). *Digest of Education Statistics, 2012* (NCES 2014-015), Chapter 3. *http://nces.ed.gov/fastfacts/display.asp?id=98*

[2] Bloomberg, "Cost of College Degree in U.S. Soars 12-Fold", August 15, 2012. *http://www.bloomberg.com/news/2012-08-15/cost-of-college-degree-in-u-s-soars-12-fold-chart-of-the-day.html*

[3] New York Federal Reserve Board, Current Issues in Economics, "Do Benefits of Colleges Still Outweigh the Costs?" May 2014. *http://www.ny.frb.org/research/current_issues/ci20-3.pdf*

role in this process by offering products to help finance college and by working with students and their families on planning for their futures. Before many students take their first college tour, their families have already benefited from a multitude of services provided by financial institutions as they manage their savings. Increasingly, families obtain important advice on paying for college tailored to their needs. We think it is never too early to begin this planning process. Financial institutions, particularly retail banks, want to help their customers with this pivotal opportunity, but the role of financial institutions in higher education lending today is quite limited. I would like to provide you an update on student lending by the private sector.

Today, the Federal Government Dominates the Student-Lending Marketplace

The Department of Education (DOE) disburses roughly $100–110 billion per year through the Federal Stafford and PLUS programs, 92 percent of student and parent loans,[4] compared to $6.5–7.5 billion dispersed by private lenders.[5] Of the more than $1 trillion in outstanding student loan debt, less than 8 percent are private loans. According to the data analysis firm MeasureOne, which surveyed the seven largest private student lenders accounting for 90–95 percent of the private loan market, only $90 billion of the $1.2 trillion in outstanding student loan debt consists of private loans.[6]

In the wake of the financial crisis, many private student lenders strengthened their underwriting standards, while others continued their long-standing practice of conservative underwriting, and the performance of private student loans has responded accordingly with delinquency and default rates dropping markedly. Private student loans carry no Government guaranty, so if they are not repaid, the lender loses.

As Beth Akers of the Brookings Institute recently wrote, "[The evidence] does not indicate that aggressive regulation of the private lending industry is necessary. As discussed, financial institutions have little incentive to provide loans they do not expect the borrower to repay. In this sense, the industry is self-regulating by design."[7]

For a lender to offer a sound private loan product, as required by prudential regulators, applications must be put through a robust underwriting process, where a determination is made whether the potential borrower is likely to repay their loans. Lenders encourage the use of cosigners, who often have more extensive credit histories and better credit scores than students, in order to offer the lowest possible interest rates for consumers. Unlike with Federal Direct Loans, origination fees are not charged.

Data compiled in the MeasureOne 2013 survey of private student lenders, and reflected once again in the second Report issued two days ago (July 29th), clearly demonstrates the value of sound underwriting that responsibly assesses a borrower's ability to repay—delinquencies and defaults are declining and are at the lowest level since the credit crisis. Continuing strong private loan performance shows:

- Early stage delinquencies (30 to 89 days past due) declined 17 percent from Q1 2013 to Q1 2014 from 3.59 percent to 2.97 percent.
- Serious delinquencies (90+ days past due) declined 13 percent from Q1 2013 to Q1 2014 from 2.92 percent to 2.55 percent.
- Charge off rates also declined to post credit-crisis lows with rates dropping from 3.5 percent in Q1 2013 to 3.16 percent in Q1 2014.

Nearly three out of four private student loans are in active repayment status, as opposed to deferment or forbearance, a high rate which again illustrates that private student loan borrowers are successfully managing their repayment obligations.

By way of comparison, the Federal student loan program carries a 3-year cohort default rate of more than 14 percent.[8] Further, much of the Federal loan portfolio is not in an active repayment status. Of those loans in active repayment, multiple reports have estimated more than 40 percent will default or become at least 90 days

[4] College Board, "Trends in Student Aid 2013". *https://trends.collegeboard.org/student-aid/figures-tables/growth-federal-and-nonfederal-loans-over-time*

[5] Measure One, "Private Student Loan Report 2013". *http://www.measureone.com/reports*

[6] Measure One, "Private Student Loan Report 2013". *http://www.measureone.com/reports*

[7] Center for Higher Education Reform, "How Much Is Too Much: Evidence on Financial Well Being and Student Loan Debt", May 2014. *http://www.aei.org/files/2014/05/14/-how-much-is-too-much__100837569045.pdf*

[8] U.S. Department of Education, Office of Federal Student Aid, National Default Rate Briefings for FY2011 2-Year Rates and FY2010 3-Year Rates. *http://www.ifap.ed.gov/eannouncements/093013CDRNationalBriefings2YRand3YR.html*

delinquent.[9] This is in spite of generous income-based repayment plans. Data available from the Consumer Financial Protection Bureau (CFPB) and others shows the average balance of income-driven repayment plans stands at more than $45,000, with an average defaulted Federal loan balance of $14,000.[10] This suggests income based repayment plans are helping certain types of borrowers, but may not be a "silver bullet" in terms of eliminating all Federal loan defaults.

Though Both Federal and Private Student Loans Support the Attainment of Higher Education, These Products Are Quite Different in Structure and Design

As has been well-chronicled, there are numerous repayment options on Federal student loans, including monthly payment plans tied to income, as well as easily available deferments and forbearances for times of economic hardship. Repayment flexibility is particularly necessary on Federal student loans because Federal student loans lack a robust assessment of a borrower's ability to repay. As then-CFPB Associate Director Raj Date has said, "If you are going to lend money, you should probably care about getting paid back. And if you care about getting paid back, you should probably inquire about, and evaluate, a borrower's ability to pay you back."[11]

However, the unique nature of the Federal student loan program means traditional measures of ability to repay may not be useful for a large portion of these programs. The Federal loan programs are designed to foster access to higher education, and the loans are meant to be repaid with future earnings. Annual and cumulative loan limits are somewhat helpful in preventing undergraduate Federal Stafford Loan borrowers from over-borrowing. However, the PLUS Loan Program for parents and graduate students is designed to supplement the Federal Stafford Programs. These loans are available up to the full cost of attendance, including living expenses, and only include a high-level check for major adverse credit events—they do not include a prospective assessment of the borrower's ability to repay.

By contrast, private student lenders are required to provide comprehensive disclosures of terms, conditions, and full life-loan borrowing costs at multiple times throughout the origination process—i.e., at application, approval, and consummation—and to tell students and families about Federal aid programs' terms as well.[12] Private education loans are critical to helping families fund the gap between other available financial aid and the total cost of attendance. Through multiple disclosures and ongoing communications, private education lenders assure students and families are well informed about the cost and terms of their loans.

Private lenders must carefully assess ability to repay, and usually cosigners are required or encouraged, because the borrower often lacks credit history. In addition, private student loans are school-certified to prevent students from over-borrowing. Though only self-certification from the borrower is required under law, 96 percent of today's private student loans are also school-certified to ensure students are not borrowing beyond their need.[13] The remaining four percent of private loans which are noncertified are loan refinancing for students no longer enrolled, or are designed specifically for professional school graduates no longer affiliated with their institution, such as loans for law graduates preparing for the bar exam or medical school graduates in a residency program.

More than simply recouping their funds on the loan, banks involved in private student lending have the added incentive to provide excellent service to student loan borrowers because they are prospective customers for future products and services they will need when they leave school. Banks seek to develop trust and loyalty by providing quality products and services.

The combination of current and future economic incentives results in good customer service for private student loans. Analyzing data from a recent report by the CFPB, only 0.03 percent of private student loans received a complaint from con-

[9] Institute for Higher Education Policy, "Delinquency: The Untold Story of Student Loan Borrowing", March 2011. *http://www.ihep.org/assets/files/publications/a-f/delinquency-the_untold_story_final_march_2011.pdf*

[10] Consumer Financial Protection Bureau Blog, "A Closer Look at the Trillion", April 2013. *http://www.consumerfinance.gov/blog/a-closer-look-at-the-trillion/*

[11] Remarks of Raj Date, American Bankers Association Conference, Orlando, FL, June 2012. *http://www.consumerfinance.gov/newsroom/remarks-by-raj-date-to-the-american-bankers-association-conference/*

[12] Federal Reserve Amendments to Regulation Z (Truth in Lending), July 30, 2009. *http://www.federalreserve.gov/newsevents/press/bcreg/20090730a.htm*

[13] Measure One, "Private Student Loan Report 2013". *http://www.measureone.com/reports*

sumers.[14] CBA's members adhere to the "one complaint is too many" philosophy but this incredibly low complaint rate suggests a high degree of customer satisfaction.

In Spite of Its Relatively Small Size, the Private Student Loan Market Continues To Respond to Consumer Demand

Private student lenders continue to respond to the needs of their customers. Lenders now offer private student loans with both fixed and variable rates, and most carry no origination fees, unlike Federal loans. Private lenders continue to meet current refinancing needs, while also increasing their refinance offerings to accommodate customer demand. As far as refinancing existing private student loans, lenders are equipped to handle current demand. Several CBA members have offered a refinance product for some time, and others are beginning to launch new programs or are developing them. We expect demand for private loan refinance products to continue to grow, but the largest potential win/win for consumers and financial institutions may lie in the private refinancing of Federal student loans.

Ironically, the CFPB may significantly inhibit the development of products to refinance Federal student loans due to uncertainty over how the Bureau and the courts are defining "UDAAP" (Unfair, Deceptive, and Abusive Acts of Practices). Even though they may be able to provide a lower rate, most private lenders are reluctant to refinance Federal loans until it is clear they will not be liable for a UDAAP violation, because the loans are not eligible for Federal income based repayment programs. CBA urges the CFPB, with the support of Congress, to clarify financial institutions will not be penalized for offering their customers well-informed choices to refinance their Federal student loans.

While 98 percent of private loans demonstrate ongoing successful repayment, banks remain committed to providing robust options to the very small subset of private loan customers experiencing sustained financial distress. For the most distressed borrowers, banks continue to work with the prudential regulators to develop short and long term loan modification programs to provide borrowers with more flexibility, particularly in the early stages of their career. Some banks already have launched loan modification programs, while others are piloting programs in advance of a broader roll-out. These programs are designed to address the unique nature of student loan borrowers within the confines of safety and soundness principles.

Two major options are available for families to "fill the gap" in paying for college: the Parent PLUS loan or a private education loan.

- *Parent PLUS:* The Federal Government disbursed $10 billion to parents of undergraduate students last year at a fixed rate of 6.41 percent with no ability-to-repay assessment, only a review of serious previous credit problems. The Government is also currently charging origination fees of 4.288 percent on all PLUS loans, a fee that budget sequestration is increasing every year.[15] Parent PLUS loans have no debt-to-income ratio test and, because the parent is not the beneficiary of the education, the loan does not offer income based repayment. A private education lender would never make this type of loan.
- *Private Education Loan:* A private education loan protects families from over borrowing through sound underwriting, including a thorough review of ability to pay. Over 90 percent of undergraduate loans have cosigners—most of these loans are provided to the student, who benefits from the education, with a parent as a cosigner. Unlike the PLUS loan, parents who do not have the income to afford the debt are protected from taking out a loan they cannot pay. This is the ultimate consumer protection—ensuring a family does not undertake an obligation they cannot afford.

The benefit of the cosigner for the student cannot be overstated. A cosigner not only lowers credit risk to the point where a young person can get a loan, but he or she also helps the borrower secure a lower rate, and establish credit.

Banks Take Every Possible Step To Ensure Servicemembers and Veterans Receive the Benefits Afforded to Them

CBA members place compliance with the Servicemembers Civil Relief Act (SCRA) as a top priority. The SCRA caps the interest rate on loans taken out before military service at 6 percent and provides for deferments and forbearances of payments and other benefits during the service period. It is much easier for our members to ensure

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[14] CFPB "Mid-Year Update on Student Loan Complaints". April 2014. *http://www.consumerfinance.gov/newsroom/cfpb-finds-private-student-loan-borrowers-face-auto-default-when-co-signer-dies-or-goes-bankrupt/*

[15] U.S. Department of Education, Office of Federal Student Aid: *https://studentaid.ed.gov/announcements/sequestration.*

SCRA compliance on their private student loans than on their remaining FFELP loans due to conflicting statutes and regulatory guidance from Federal agencies. CBA and others involved in the student lending community have asked the DOE for new guidance, which we have been told to expect soon, to clarify the regulations and allow loan holders and servicers to streamline the process of providing SCRA benefits to their eligible customers. We look forward to its release so servicemembers can have maximum flexibility in obtaining the benefits they deserve.[16]

In addition to providing a small but critical component of the education funding process, financial institutions play an important role on campuses by offering banking services such as checking and savings accounts designed specifically to meet students' unique needs and help establish their credit history.

Banks Provide Valuable Financial Services and Products to Millions of Students

Some CBA members have entered into agreements with institutions of higher education to provide useful services, such as campus ID cards that can be linked, at the option of students, faculty, staff, and others associated with the university, to a standard deposit account. These financial institutions also provide important services, such as on campus financial literacy programs and assistance with financial aid systems to colleges and universities. According to a GAO report, "Most of the college card fees we reviewed generally were not higher, or in some cases were lower, than those associated with a selection of basic or student checking accounts at national banks. In particular, college card accounts generally did not have monthly maintenance fees, while the basic checking accounts we reviewed typically did."[17]

Recently, the DOE entered into a negotiated rulemaking with a variety of stakeholders, including students, school representatives, banks, credit unions, consumer groups, and others, on the topic of "cash management," which includes the disbursement of student aid refunds, Federal aid in excess of what is needed to pay school charges. Despite significant progress among nonfederal negotiators and the offering of good-faith proposals by the bank and credit union negotiators, consensus proved elusive. This leaves the Department unbound by any agreements worked out during the negotiations, and free to write whatever changes to the regulations it wishes to propose.

CBA shares the DOE's goal of promoting students' understanding and management of financial products while ensuring they have meaningful choices. However, we have serious concerns about and objections to the expansiveness of the draft regulation related to disbursement of Federal student aid credit balances, particularly with regard to nondisbursement accounts (i.e., accounts opened outside of the Title IV credit balance disbursement process), as well as sponsored disbursement accounts. Similar apprehensions relating to the scope of the DOE's rulemaking have been expressed by members of both parties and houses of Congress.

With regards to nondisbursement accounts, though the language in the draft regulation presented by the DOE during the negotiated rulemaking is not clear, it would certainly classify as "sponsored accounts" any traditional bank deposit account linked to a "campus card," such as a college identification card, even though the depository institution offering the account does not facilitate the delivery of Federal student aid credit balances for the school—which is the true subject of the rulemaking. In addition, the draft regulation could cover any deposit account that could receive Federal student aid credit balance disbursements held by a financial institution that happens to have other types of arrangements with colleges or universities (educational institutions). As sponsored accounts, these accounts would be subject to various requirements and significant restrictions under the proposed regulation, impacting relationships that have nothing whatsoever to do with the disbursement of Federal student aid credit balances.

While the DOE has authority to write rules concerning Title IV financial aid disbursement and the methods under which disbursements are made, the proposed rule would go beyond that scope and regulate the availability and terms of deposit accounts, including debit cards and prepaid cards, available to students from depository institutions—separate and apart from the financial aid disbursement process. We can identify no authority for DOE's overreach to regulate deposit accounts that have, at best, only a tangential relationship with those accounts.

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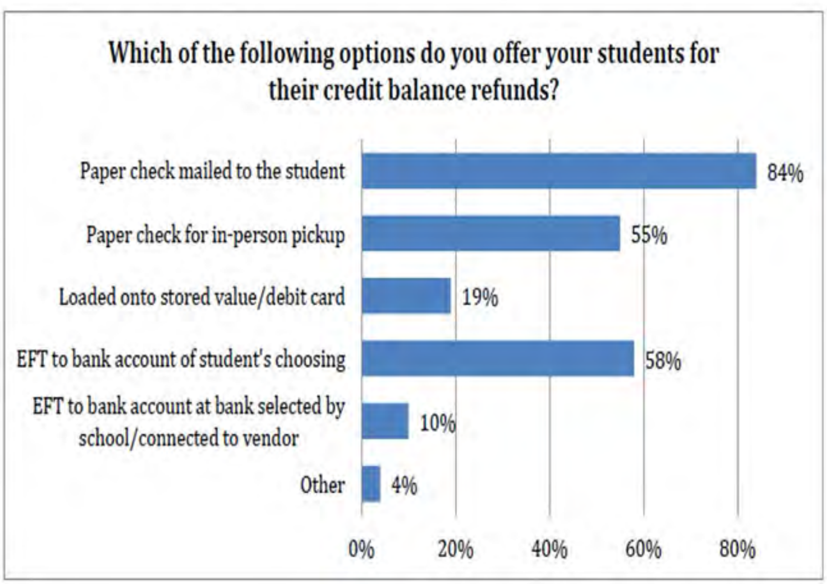
[16] CBA/EFC/SLSA letter to Secretary Duncan on SCRA, May 2014. *http://www.cbanet.org/documents/2014%20Comment%20Letters/2014-05-21%20CBA-SLSA-EFC%20Letter%20to%20Secretary%20Duncan.pdf*

[17] "College Debit Cards: Actions Needed To Address ATM Access, Student Choice, and Transparency" (February 2014). *http://www.gao.gov/assets/670/660919.pdf*

Moreover, and more importantly, this broad scope would have a chilling effect on the offering of accounts designed for students and would deprive students of choice and access to valuable, low-cost, and convenient access to bank services, accounts that can be especially useful to those students who arrive on campus without a bank account. For these reasons, we have urged the DOE to reconsider its draft regulation so it does not cover these traditional bank products and services to the extent they are offered outside of disbursement services (i.e., to the extent the deposit account opening process is not integrated within the Federal student aid credit balance disbursement process).

In addition to our concerns regarding non-Title IV disbursement accounts and services, we are concerned the proposed regulation will effectively eliminate Federal student aid credit balance disbursement accounts—that is, accounts specifically designed to disburse Federal student aid credit balances—to the detriment of students and educational institutions.

Federal student aid is disbursed directly to colleges and universities, which use the funds to satisfy a student's tuition expenses and then disburse the remaining funds to the student to be available for other appropriately related purposes. The DOE has issued a series of student aid credit balance disbursement regulations, which have increased the operational complexity of disbursing these funds to students. Financial service providers have partnered with educational institutions to help these educational institutions satisfy the DOE disbursement requirements. These arrangements enable colleges and universities to reduce the costs of disbursing Federal student aid credit balances by utilizing direct deposit, rather than mailing paper checks, thereby decreasing costs for students and schools and provides to students, safe, quick, and convenient access to funds. In some of these arrangements, financial institutions may offer students a deposit account within the credit balance disbursement process itself or, when instructed by the educational institutions, provide them with a prepaid card to access Federal student aid credit balances, particularly where a student does not have a preexisting account to accept a direct deposit of funds. Most importantly, these products and services are always offered as options and are never a requirement. As evidenced by the chart below, institutions of higher education offer students a variety of options for receiving excess student aid funds. Paper checks along with ETFs to a bank account of the student's choosing are the most prevalent methods for disbursing these funds.[18]



[18] "NACUBO Response to CFPB Request for Information on Campus Products and Services", March 2013. *http://www.nacua.org/Documents/NACUBO__LetterToGarryReeder.pdf*

For those students who do not have, or cannot easily access, an existing bank account, a letter from the National Association of College and University Business Officers (NACUBO) notes, "campus banking relationships can streamline the process of establishing a new account or a prepaid card option provides an alternative to a check."[19]

The draft regulation presented by the DOE during the aforementioned negotiated rulemaking would effectively deprive students and educational institutions of these services by compelling financial institutions currently providing such "sponsored accounts"—including those in no way opened in connection with the credit balance refund process—to stop providing them to tens of thousands of students on multiple campuses. Draft regulation would restrict nearly all income sources associated with the maintenance and use of these products. With limited or no means to support the cost of providing the services, providers may have no choice but to exit the business and close existing accounts.

The result would be thousands of students losing a convenient, safe, and quick option to access their Federal student aid credit balances, and the convenience of a single card that—at the election of the student—can combine financial and school functionality. Payments to students via checks would be more prevalent, especially for those without bank accounts, delaying the students' access to the funds and potentially causing them to incur off-campus check cashing fees. In addition, it is worth noting the CFPB found that requiring disbursement through electronic fund transfer can reduce fraud and costs.[20]

CBA is hopeful all involved in this process come to understand how banking relationships on campus provide students access to a range of financial products and options to meet their needs. It is especially important that the function of providing general financial services is not adversely affected by concerns over the separate issue of making Federal aid funds available to students who wish to have funds deposited directly into a bank account, instead of being given cash or a check.

Conclusion

CBA Members remain proud of the work they do to provide products and services for college students. Whether it is a private student loan or a student checking account, CBA Members want to offer these products in a way which best serves their consumers. As students continue to better themselves and their economic prospects by earning high education degrees, the Nation's retail banks will continue to develop services that allow them to prove themselves worthy of these prospective customers.

Thank you for the opportunity to testify on behalf of CBA's Membership. CBA looks forward to the opportunity to work with Congress to ensure millions of Americans can pursue education that meets their needs and aspirations.

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[19] "NACUBO Response to CFPB Request for Information on Campus Products and Services", March 2013. *http://www.nacua.org/Documents/NACUBO_LetterToGarryReeder.pdf*

[20] "Perspectives on Financial Products Marketed to College Students", Presentation to the Department of Education Negotiated Rulemaking Session. March, 26, 2014 (pp. 3, 7).

RESPONSES TO WRITTEN QUESTIONS OF SENATOR REED FROM DAVID A. BERGERON

Q.1. We have seen student loan debt rise dramatically over the last 10 years. Right now borrowers and the Federal Government bear all of the risk with these loans.

I have proposed the Protect Student Borrowers Act to ensure that institutions have skin in the game when it comes to student loans. In other words, colleges and universities would be on the hook for a percentage of the loans that go into default. How would you ensure that institutions have a stake in ensuring students can repay their loans?

A.1. In a report which I wrote for the Center for American Progress earlier this year, "What Does Value Look Like in Higher Education?", I made a specific proposal for risk-sharing that would require all but the top performing institutions to buy a special class of 10-year Treasury notes with yields equal to the most recent cohort's default rate multiplied by prior-year loan volume. The base yield would be the same as regular 10-year Treasury notes. However, under my proposal, institutions with better-than-expected graduation and repayment rates would receive a bonus, while institutions with poorer-than-expected graduation and repayment rates would receive a lower yield.

On August 22, the yield on the current 10-year Treasury notes was 2.4 percent. Under this proposal, an institution that had a graduation rate that was 10 percent better than expected might receive a yield of 2.65 percent on the notes that they were required to buy, while an institution that had a graduation rate that was 10 percent lower than expected might receive a yield of 2.15 percent.

Such an approach would address two problems in higher education funding. First, it would provide a financial incentive to not just enroll students but also to ensure that they graduate. Second, it would provide an alternative funding stream that could help bridge the "feast and famine" cycle under which institutions see revenues fall as enrollments grow during economic downturns.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR REED FROM KENNETH KOCER

Q.1. We have seen student loan debt rise dramatically over the last 10 years. Right now borrowers and the Federal Government bear all of the risk with these loans.

I have proposed the Protect Student Borrowers Act to ensure that institutions have skin in the game when it comes to student loans. In other words, colleges and universities would be on the hook for a percentage of the loans that go into default. How would you ensure that institutions have a stake in ensuring students can repay their loans?

A.1. Schools currently do have "skin in the game." If institutions do not maintain default rates below U.S. Department of Education guidelines, future Federal aid will be suspended to those institutions. This is a powerful incentive and for this reason it is to the benefit of schools to maintain low default rates. The current Federal regulations state "if a schools cohort default rate equals or exceeds 30 percent for the three most recent fiscal years or if the most recent cohort default rate is greater than 40 percent, the school is considered not administratively capable and may become ineligible to participate in the Federal Direct Loan, Federal Pell Grant, or Federal Perkins Loan Programs."

In addition, the Federal Government gives institutions no leeway or authority to reduce or deny Federal Direct Loans to students, which could assist in lowering their loan debt. Asking the institutions to be responsible for loans, for which they have no control to deny, would not be a proper approach.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR REED FROM RICHARD HUNT

Q.1. We have seen student loan debt rise dramatically over the last 10 years. Right now borrowers and the Federal Government bear all of the risk with these loans.

I have proposed the Protect Student Borrowers Act to ensure that institutions have skin in the game when it comes to student loans. In other words, colleges and universities would be on the hook for a percentage of the loans that go into default. How would you ensure that institutions have a stake in ensuring students can repay their loans?

A.1. Banks are quite experienced with having skin in the game when they make loans. For private loans made today, banks are on the hook for the entire amount loaned since there is no Government guaranty or other recourse if the loan is not repaid. For that reason, banks have to be careful in the lending process to make sure there is a strong chance the loan will be repaid. Banks also have experience with risk sharing with the Federal Government, a model used in the Federal Family Education Loan Program since about 1994, where banks are only insured for 95 to 98 percent of the balance of a defaulted loan. The concept of risk sharing is a good one, I believe, and could serve to reduce Federal default costs in the Direct Loan Program while also encouraging schools to emphasize job placement services for their graduates as well as to do everything they can to help their students complete their course of study.

Q.2. In your testimony, you discuss the strong underwriting and strong performance of the private loan portfolio. You also say that the private sector is responding sufficiently to the demand for refinancing of student loans.

A.2. The private student loan marketplace was relatively new during the past decade, so underwriting standards were not as well developed as they are today and the structure of the market has changed. Loans made during the 2002–2008 period were made according to the underwriting standards set by a private student loan insurer. Many were also sold into the secondary market, especially loans made by nonbanks. After 2008, as illustrated by the contraction of the market, underwriting standards tightened considerably. Banks made some loans that failed to perform as expected during the 2002–2008, period, but since most defaults occur during the first 2 to 3 years of repayment, the loans that have not already been charged off from that period are performing well today.

As I stated in my testimony, refinancing options are widely available today for private student loans, regardless of when the loan was originated. Another product is about to be announced by a major bank, and more banks have plans underway for refinancing. In addition, there are numerous loan modification opportunities featuring interest rate reductions and loan-term extensions for borrowers who are struggling with repayment.

CBA and our member banks have been working with bank regulators since 2010 to be permitted to offer more options to borrowers who need help. The regulators now allow lenders the option to provide borrowers an additional 6-month grace period if needed after repayment is supposed to begin. Two to three month payment extension (hardship forbearance) options are available on an annual basis for borrowers who are struggling with repayment. Banks also offer interest rate reductions to borrowers utilizing automated payments.

Additionally, all of CBA's member banks who originate private student loans forgive a loan in the event of the death of a student. Since 2008, CBA members have forgiven over 3,200 loans, totaling over $38.5 million. The death of a student is very rare, but when it does occur CBA's members do not want families to have to shoulder a financial burden on top of their heartbreak. In other circumstances where students or their families have a hardship, CBA's members are working one-on-one with them to assist through short- or long-term loan modifications, refinancing, payment extensions, or other payment options. We are committed to working with students and their families to manage their loans through the unexpectedness of life, and this is why the private student loan market has an incredibly low default rate of 2.79 percent.

ADDITIONAL MATERIAL SUPPLIED FOR THE RECORD

LETTER FROM KANSAS STATE UNIVERSITIES SUBMITTED BY SENATOR JERRY MORAN

EMPORIA STATE UNIVERSITY
FORT HAYS STATE UNIVERSITY
KANSAS STATE UNIVERSITY
Pittsburg State University
KU THE UNIVERSITY OF KANSAS
WSU WICHITA STATE UNIVERSITY

July 17, 2014

The Honorable Jerry Moran
Russell Senate Office Building
Room 361A
Washington, DC 20510

Dear Senator Moran:

We write today to express our support and our concern regarding the ongoing rulemaking at the Department of Education (Department) addressing disbursement of student loan funds under Title IV of the Higher Education Act (HEA). We appreciate your attention to this matter and also your support for students in Kansas, and the university communities that serve them.

We strongly support the Department's efforts to curb deceptive business practices by bad actors on college campuses. However, we must strongly caution against precipitous action on the part of the Department that could inadvertently place upward pressure on tuition costs and limit the provision of educational services offered by colleges and universities across our state.

We agree with the Department's stated objective to ensure students have "safe, convenient and free access to the credit balance of their Title IV HEA funds." However we must ask that the department does not punish the good actors in their pursuit of the bad, and in so doing hurt the very universities and students that the Department aims to guide and support. Doing so could end innovative private-public relationships between good financial institutions and Kansas schools that have decreased educational costs for students and equipped schools to charge lower fees as they provide more and better services.

We are concerned that the Department will attempt to regulate products designed to disburse Title IV loan funds and in that process will also regulate any "arrangement…under which a student opens, or is referred to open, a financial account... into which Title IV, HEA program funds may be deposited." Such a regulation could be interpreted to cover any account held by a student or parent if the financial institution had any arrangement, however informal, with a school and regardless of when or why the student or parent opened the account with that financial institution. That would have a chilling and in some cases terminal effect on good business partnerships that currently benefit students and universities alike.

Students, often far from home, need access to safe and secure financial services. Financial experience is a necessary part of student life and is essential training for their long-term financial health. Knowing this, many schools have signed agreements with banks to provide on-campus financial solutions at low or no cost to students. These include services such as secure on-campus branches, ATMs, debit cards, and financial education programs. Any regulatory action that could potentially take away students' safe, convenient, and free access to one group of essential services while it simultaneously drives up the cost of education for that same group of students deserves to be studied with extraordinary care.

Bad actors who abuse students in the process of disbursing student aid deserve to be called to account. We support the Department in their attempt to stop any such abusive practices. However, universities, students, and good financial actors often come together on campus to provide and consume essential traditional banking services that help lower student fees and provide essential educational experience for the students. It would be counter-productive, to say the least, to condemn those beneficial relationships in pursuit of the abusive ones. We ask that the Department fully study the implications of its draft regulations and agree to take only those actions that will not harm the good financial actors, universities, and students. The Department should not issue regulations to block or discourage agreements between financial institutions and schools that provide the benefit of efficient, safe, and low or no-cost traditional banking services on campus.

Sincerely,

Michael Shonrock
President
Emporia State University

Mirta Martin
President
Fort Hays State University

Kirk Schulz
President
Kansas State University

Steve Scott
President
Pittsburg State University

Bernadette Gray-Little
Chancellor
University of Kansas

John Bardo
President
Wichita State University

STATEMENT SUBMITTED BY AMERICANS FOR FINANCIAL REFORM

August 1, 2014

U.S. Committee on Banking, Housing, and Urban Affairs
534 Dirksen Senate Office Building
Washington DC 20510

Thank you for the opportunity to submit written comments for the record in regards to the Senate Banking Committee's hearing, "Financial Products for Students: Issues and Challenges." These comments are on behalf of Americans for Financial Reform, a coalition of more than 200 national, state and local groups who have come together to reform the financial industry. Members of our coalition include consumer, civil rights, investor, retiree, community, labor, faith based and business groups.

Against the backdrop of $1.2 trillion dollars in outstanding student loan debt that is currently dragging on individual borrowers and the economy more broadly, it is imperative that our federal lawmakers take steps to change banking and financial firm practices that contribute to that debt burden. Students continue to be at risk when assuming private education loan products to help pay for college; those carrying federal student loan debt also encounter practices that can drive up their debt burdens and hurt their credit histories while in repayment. In addition to some features of student lending itself, members of our coalition are focused on the issues of debit cards and bank accounts that students are exposed to each term. The Department of Education relies on private contractors to provide essential servicing and collection services. Unfortunately, the Department has repeatedly allowed these companies to place profit over borrowers rights without exercising proper oversight.

As outlined in testimony from U.S. PIRG, there is significant evidence that campus-sponsored bank accounts are a poor deal for students, and some of our concerns are outlined below. For significant numbers of students, college is the first time in their lives that they have financial independence and responsibility. Unfortunately, students face unforeseen tricks and traps that are layered into high cost products, like campus bank accounts and debit cards. Currently, many students are hit with fees when they try to access their federal aid refunds through bank accounts and prepaid debit cards that are sponsored by their campuses. Low-income students tend to receive the most financial aid, and thus end up the targets for these products and the corresponding and unavoidable fees. These extra fees, combined with the other costs associated with getting an education, can overwhelm students to the point of withdrawal from post-secondary programs.

Financial products are growing more ubiquitous on college campuses. U.S. PIRG found in their report, "*The Campus Debit Card Trap,*" that two out of every five college students are exposed to debit cards on their campuses that may drive up their costs.[1] At some campuses, students with

[1] Report, *The Campus Debit Card Trap*, U.S. Public Interest Research Group Education Fund, May 30, 2012. http://www.uspirg.org/reports/usp/campus-debit-card-trap

cards are charged steep fees when trying to access their federal financial aid, including PIN transaction fees at the point of sale and high overdraft fees. Students are enrolling in these products often because of years of deceptive marketing by banks and financial firms, along with, in many cases, revenue-sharing agreements with campus administrators that allow these firms to gain access to students. The specific agreements between campuses and industry firms can range from firms making payments for the right to use the school's logo on their products, to providing bonuses for the recruitment of students. We believe there is a conflict of interest inherent in these agreements that is problematic for student consumers—not dissimilar to the conflicts seen around private student loans and campus credit cards, which garnered decisive action in recent years by both Congress and the Department of Education.

Our coalition is supportive of legislation that would ban revenue-sharing agreements between colleges and banks or financial firms that are crafted solely to offer bank accounts or related products to students on campus.

Banks and financial firms also target students with private student loans. These loans are high risk -- typically variable interest rates that are higher for borrowers with lesser means. These loans also come with severely limited repayment options, a problem reinforced by the fact that they cannot be discharged in bankruptcy. And unfortunately, the market for private student loans is currently expanding, after shrinking during the financial crisis. Due to the risky nature of these loans, private student loan borrowers need protections. To prevent students from turning unnecessarily to risky private loans before they have exhausted their federal loan options private loans should be required to be certified by the student's financial aid office before approval. To alleviate the undue burden that private student loans may cause for borrowers in distress, these products should be dischargeable in bankruptcy just like other consumer loan products. Short of bankruptcy, borrowers experiencing a financial setback should be allowed to modify their loans to keep them manageable in repayment. Currently, the private student loan marketplace offers virtually no relief to distressed borrowers.

Finally, the large financial firms behind federal student lending include high profile brands like Sallie Mae, as well as large non-profit players like PHEAA (Pennsylvania Higher Education Assistance Agency). These companies service federal loan borrowers in repayment but their practices too often cause borrowers to incur higher costs. Specifically, millions of borrowers who qualify for alternative repayment programs like Income Based Repayment and Public Service Loan Forgiveness are not enrolled. Additionally, their loans may be transferred to another servicer at any time, and the variance in servicer payment-policies can snag borrowers, resulting in higher rates or penalties. Amazingly, borrowers are not allowed to switch servicers unless they consolidate their loans. In short, federal student loan borrowers need strong consumer protections in repayment, and we urge the Committee to provide them. The recent Inspector General report sheds a shocking light on the lack of oversight and persistent abuses in the student loan collection industry. Despite the history of consumer abuses in the collection industry, the United States government hires collectors not only to collect money, but also to communicate with borrowers about options to address student loan debt and to help borrowers resolve debt. There is inherent conflict in these dual responsibilities. Communicating with borrowers about options and helping them resolve their student loan debts is simply not the primary mission of collection agencies. Debt collectors are not adequately trained to understand and administer the complex borrower rights available under the Higher Education Act.

Although the government must balance the need to collect student loans and the need to assist borrowers, the current system heavily favors high pressure collection and collector profits, to the detriment of financially distressed borrowers seeking the help they so desperately need.

We thank the committee for your attention to these matters.

Sincerely,

Americans for Financial Reform

Center for Digital Democracy

Center for Responsible Lending

Consumers Union

Empire Justice Center

NAACP

National Association of Consumer Advocates

U.S. Student Association

Woodstock Institute

STATEMENT SUBMITTED BY THE INSTITUTE FOR COLLEGE ACCESS AND SUCCESS

the institute for
college access & success

U.S. Senate Committee on Banking, Housing and Urban Affairs Hearing
"Financial Products for Students: Issues and Challenges"
Thursday, July 31, 2014
10:00 AM – 12:00 PM

Thank you for the opportunity to submit comments for the record for the Senate Banking Committee Hearing entitled, "Financial Products for Students: Issues and Challenges." These comments are submitted on behalf of The Institute for College Access & Success (TICAS).

TICAS is an independent, nonprofit organization that works to make higher education more available and affordable for people of all backgrounds. TICAS is home to the Project on Student Debt, which seeks to increase public understanding of rising student debt and the implications for our families, economy, and society.

Private education loans are one of the riskiest ways to finance a college education. Like credit cards, they usually have variable interest rates that are higher for those who can least afford them. Analysis of federal data from 2011-12 reveals that almost half of borrowers could be using more affordable federal loans. We join with the recommendation of the president of the South Dakota Association of Student Financial Aid Administrators that school certification of all private education loans should be required. Requiring that private loans are submitted to schools for certification, and that schools are required to inform students if they could borrow more in safer federal loans instead will help to prevent unnecessary private loan borrowing.

In addition, we wish to submit for the record the following TICAS publications which include important information and policy recommendations related to federal and private student loans:

1) *Private Loans: Facts and Trends*: presents data and trends in risky private loan use.

2) *At What Cost? How Community Colleges That Do Not Offer Federal Loans Put Students at Risk*: analyzes the risks to students who attend community colleges that do not offer federal loans and makes recommendations for promoting access to safer federal aid and preventing defaults.

3) *Aligning the Means and the Ends: How to Improve Federal Student Aid and Increase College Access and Success*: comprehensive policy recommendations designed to

address college affordability, access, quality, and completion, including detailed recommendations related to federal and private student loans.

We thank the Senate Banking Committee for holding this hearing and for the opportunity to provide comment.

Sincerely,

Joseph Mais
Senior Policy Analyst/DC Director

the institute for college access & success

PRIVATE LOANS: FACTS AND TRENDS

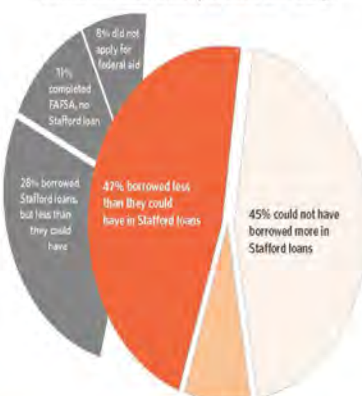
JUNE 2014

Private loans are one of the riskiest ways to finance a college education. Like credit cards, they typically have variable interest rates. Both variable and fixed rates are higher for those who can least afford them — as high as 13% in June 2014.[1] Private loans are not eligible for the important deferment, income-based repayment, or loan forgiveness options that come with federal student loans. Private loans are also much harder than other forms of consumer debt to discharge in bankruptcy.

The following facts and figures reflect the most recent data available about undergraduate private loan borrowing and the evolving private loan market. The figures represent borrowing in one academic year (2011-12). For data on cumulative student debt (both federal and private loans) at graduation with a bachelor's degree, see *Quick Facts About Student Debt*, http://bit.ly/1lxjskr.

Private loan volume is increasing after earlier declines. Private loan volume has been rising since 2010-11. Data show that annual volume peaked at $18.1 billion in 2007-08 before the credit crunch, then decreased to $5.2 billion by 2010-11 before increasing to $5.5 billion in 2011-12 and $6.2 billion in 2012-13.[2]

Private Loan Borrowers by Stafford Loan Usage



Almost half of borrowers could be using more affordable federal loans.

Experts agree that students and families should exhaust all of their federal aid options before even considering private loans. However, almost half (47%) of private loan borrowers in 2011-12 borrowed less than they could have in safer federal Stafford loans:[3]

- 19% took out no Stafford loans at all. This includes: 8% did not apply for federal financial aid, and 11% did apply for federal aid (a requirement for Stafford loans) but did not take out a Stafford loan.
- 28% had Stafford loans, but borrowed less than they could have.

Almost half of private loan borrowers attend lower priced schools.

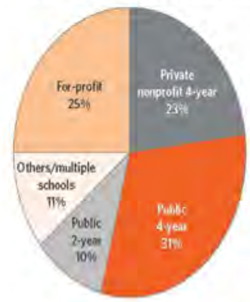
- In 2011-12, almost half (48%) of private loan borrowers attended schools charging $10,000 or less in tuition and fees.
- Although almost half of all private loan borrowers attended lower priced schools, private loan borrowers are disproportionately represented at higher cost schools. In 2011-12, four in 10 (43%) private loan borrowers attended schools that charge tuition and fees above $10,000, while only 19% of all undergraduates attended such schools.[4]

Private Loans: Facts and Trends

Private loan borrowers disproportionately attend for-profit and private nonprofit colleges. In 2011-12, for-profit colleges and private nonprofit four-year colleges had disproportionate shares of students with private loans.

- Students attending *for-profit* colleges comprised about 13% of all undergraduates, but 25% of those with private loans.
- Students attending *private nonprofit four-year* colleges comprised about 11% of all undergraduates, but 23% of those with private loans.
- The share of all undergraduates attending *public four-year* colleges (28%) was similar to the percentage of private loan borrowers who attend these schools (31%).
- Students attending *public two-year* colleges are least likely to take out private loans: they comprised about 38% of all undergraduates but only 10% of private loan borrowers.[5]

Private Loan Borrowers by Type of School



Almost 1.4 million undergraduates borrowed private loans in 2011-12. According to federal survey data available every four years, 6% of all undergraduates - 1,373,000 students - borrowed private loans in 2011-12. This represents a sharp decline from 2007-08, when 14% of undergraduates - 2,901,000 students - borrowed private loans as the market peaked before declining with the financial crisis. But the number and share of students borrowing private loans were higher in 2011-12 than in 2003-04, when only 5% of undergraduates - 930,000 students - borrowed.

Private loan borrowing by sector in 2011-12:

- At *for-profit* colleges: 12% of students had private loans, down from 40% in 2007-08.
- At *private nonprofit four-year* colleges: 12% of students had private loans, down from 26% in 2007-08.
- At *public four-year* colleges: 7% of students had private loans, down from 14% in 2007-08.
- At *public two-year* colleges: 2% of students had private loans, down from 4% in 2007-08.

Racial/ethnic differences in borrowing that emerged at the height of the private loan market had disappeared by 2011-12. In 2007-08, African Americans were more likely than other groups to take out private loans, in contrast to 2003-04 and 2011-12. There were no substantial differences in students' likelihood of borrowing private loans by race/ethnicity in 2003-04 or 2011-12. Since private loan borrowing rates by race/ethnicity are available only every four years, there are no public data on whether differential rates of borrowing are reappearing as the market expands again.

[1] For example, Wells Fargo advertised fixed rates from 7.49% to 13.34% for the Wells Fargo Student Loan for Career and Community Colleges; https://www.wellsfargo.com/student/loans/ and https://wfefs.wellsfargo.com/terms/todays_rates.jsp, accessed June 27, 2014.

[2] Volume data are for all undergraduates and are from Table 2A, *Trends in Student Aid 2013*. The College Board. http://bit.ly/Hiw256

[3] While 47% of private loan borrowers took out less than they were eligible for in Stafford loans, 45% reached their individual annual and/or cumulative Stafford limit or were ineligible for Stafford loans because they attended less than half-time. Eligibility cannot be determined for the remaining 8% of borrowers. These figures were revised in June 2014 to reflect changes in underlying data made by the U.S. Department of Education. Individual borrowers' Stafford eligibility for 2011-12 varied by class level, dependency status, and college costs after financial aid. Some students who took out less than they were eligible for may have been ineligible for at least part of the award year because they failed to make satisfactory academic progress, previously defaulted on a federal student loan, or for various other reasons, but data limitations prevent us from quantifying the share of students who take out less than their annual limit for these reasons.

[4] While 48% of private loan borrowers attended lower-priced schools charging $10,000 or less in tuition and fees, 43% attended higher-priced schools, and cost data are not available for the remaining 10% of borrowers. Among all undergraduates, 72% attended lower priced schools, 19% attended higher priced schools, and cost data are not available for the remaining 8%. Due to rounding, figures do not add up to 100%.

[5] Nine percent of all undergraduates and 11 percent of private loan borrowers attended other types of schools or multiple schools in 2011-12. Due to rounding, figures do not add up to 100%.

Source: Unless otherwise noted, the figures in this fact sheet are based on TICAS' analysis of data from the U.S. Department of Education's National Postsecondary Student Aid Study (NPSAS), a comprehensive nationwide survey conducted every four years. Figures reflect the latest data available as of April 2014. These figures represent borrowing that took place in a single academic year, not over the entire time a student was in school. Calculations only include undergraduates who are citizens or permanent U.S. residents and attend colleges in the 50 states, or the District of Columbia. The term "private loans" is defined here to mean bank and lender-originated loans only. Some states and colleges offer non-federal student loans as well, but less than one percent of undergraduates in 2011-12 received such loans.

Suggested citation: The Institute for College Access & Success. 2014. *Private Loans: Facts and Trends*. http://bit.ly/1iEYt5E the institute for college access & success

AT WHAT COST?

HOW COMMUNITY COLLEGES THAT DO NOT OFFER FEDERAL LOANS PUT STUDENTS AT RISK

JULY 2014

EXECUTIVE SUMMARY

Each year, millions of college students borrow money to help bridge the gap between college costs and available income, savings, and grants. Experts all agree that, for those who need to borrow to pay for college, federal student loans are the safest and most affordable option. Unfortunately, some colleges choose not to participate in the federal student loan program, *preventing their students from taking advantage of them.*

Without access to affordable student loans, students who cannot afford school after available grants and scholarships are left between a rock and a hard place. They might borrow through other channels, such as private education loans or credit cards, which are more expensive, riskier, and lack the repayment options and protections of federal student loans. Alternatively, they might work longer hours to pay the bills or cut back on the number of classes they take each term – choices that research has consistently found to reduce students' chances of completing a degree or certificate.[1]

2013-14 National Findings

- Nearly *one million* community college students in 30 states – 8.5 percent of community college students nationally – were enrolled in schools that blocked all of their students' access to federal student loans.
- In 11 states, more than 10 percent of community college students lacked access to federal loans, and in seven states more than 20 percent lacked access.
- Community college students' access to federal student loans varied considerably by race and ethnicity. *Native-American, African-American, and Latino community college students were the most likely to lack access.*
- Community college students who attended schools in non-urban areas were more than twice as likely to lack access as their peers who attended schools in urban areas.

This is the Institute for College Access & Success' fourth assessment of federal student loan participation at community colleges across the country. In addition to national averages and state-by-state data for 2013-14, this issue brief takes a deeper look at activity in North Carolina and California since 2010-11, as well as reviews changes in Georgia.[2]

2013-14 State Findings

- North Carolina: Students saw an increase in loan access between 2010-11 and 2013-14, but it looks to be short lived. The state's efforts to require all community colleges to offer federal student loans have ceased, and many community colleges that had begun offering loans stopped by 2013-14 or plan to stop for 2014-15.
- California: Since 2010-11, seven more California community colleges have stopped offering federal student loans. With more than 250,000 students enrolled at non-participating schools, California remained the state with the largest number of community college students without access to federal student loans.
- Georgia: In response to 2011 changes to the HOPE Program, several of Georgia's technical colleges began offering federal loans. However, some of those same colleges have already dropped out of the program.

Colleges are understandably concerned about the potential negative consequences of student borrowing, but our analysis shows that colleges underestimate both the importance of federal loan access for students and their ability to help students make wise borrowing decisions.

[1] See: Dunlop, Erin. 2013. *What Do Stafford Loans Actually Buy You? The Effect of Stafford Loan Access on Community College Students.* National Center for Analysis of Longitudinal Data in Education Research. Working Paper 94. http://www.caldercenter.org/publications/upload/[illegible]WP.pdf. Pike, Gary R., George D. Kuh, & Ryan C. Massa-McKinley. 2009. *First-Year Students' Employment, Engagement, and Academic Achievement: Untangling the Relationship Between Work and Grades.* NASPA Journal 45(4), pp. 560-582. King, Jacqueline E. 2002. *Crucial Choices: How Students' Financial Decisions Affect Their Academic Success.* American Council on Education.

[2] We found that between 2010-11 and 2013-14, 23 colleges left and 30 colleges joined the loan program (at least three of the colleges that joined the program have plans to stop participating for 2014-15). Over half of these 53 colleges are located in North Carolina, California, and Georgia. Due to methodological changes or changes in institutional classifications, some colleges were a part of our 2010-11 analysis (*Still Denied*) or our 2013-14 analysis (*At What Cost?*) but not both. Changes in participation status include only the 1,101 colleges that were in both analyses.

TABLE OF CONTENTS

BACKGROUND

The more than 1,100 community colleges throughout the United States serve many purposes, from awarding associate degrees and certificates to facilitating transfer to four-year institutions.[3] Community colleges educate almost 40 percent of all undergraduate students in the nation, including one-quarter of all undergraduates who attend full time.[4] These public two-year colleges also provide workforce development and lifelong learning opportunities to people seeking vocational retraining or personal enrichment. As open access institutions, community colleges serve students of all backgrounds, including more very low-income and underrepresented minority students than any other type of college.[5]

While community colleges tend to charge relatively low tuition and fees, these expenses represent just part of what it costs to get through school. Other educational expenses for community college students, including books and supplies, transportation, and living costs, are comparable to those faced by students at all types of schools. In total, the average full cost of attendance at community colleges is $15,000.[6]

Federal, state, and institutional financial aid can help cover these expenses, but students at community colleges are the least likely to get grant aid compared to their peers at other types of colleges.[7] The vast majority (82 percent) of full-time community college students need financial aid to cover college costs, and hardly any of them - only two percent - have their need fully met with grants.[8] When grants and scholarships are not enough to cover college costs, students may decide to work more hours, reduce their course load, drop out of school altogether, or borrow funds so they can focus on their education.

Choosing to borrow for college is a serious decision for any student. Colleges can and should help students weigh their options for paying for school - including encouraging them to borrow only if they need to, and only as much as they need - but they

[3] Unless otherwise noted, for this analysis we use the term "community colleges" to refer to public colleges that offer degree and certificate programs of at least two years in length and at which the vast majority of credentials awarded are at or below the associate degree level. These include colleges that focus on preparing students to transfer to four-year colleges and universities, as well as technical colleges that provide vocational associate's degrees and certificates for particular careers at the undergraduate level. References to the federal student loan program pertain to the William D. Ford Direct Stafford Loan Program. For more detail about the colleges included in this analysis, please refer to the Methodology on page 21.

[4] Calculations by the Institute for College Access & Success (TICAS) on data from the U.S. Department of Education's National Postsecondary Student Aid Study, 2011-12 (NPSAS:12) for undergraduate students. Unless otherwise noted, figures from NPSAS are for citizens and permanent residents at public two-year colleges only. This differs from our general definition of community colleges in this analysis, which includes public four-year schools where the vast majority of credentials awarded are associate's degrees.

[5] Calculations by TICAS on data from the U.S. Department of Education's NPSAS:12. Very low income is defined as students with an expected family contribution (EFC) of zero. Underrepresented minority is defined as African American, Latino, and Native American.

[6] Calculations by TICAS on data from the U.S. Department of Education's NPSAS:12. Figure represents full-time students enrolled for at least nine months in 2011-12. Figure rounded to the nearest $1,000.

[7] Calculations by TICAS on data from the U.S. Department of Education's NPSAS:12.

[8] Ibid.

do their students a great disservice by opting out of the federal student loan program.

While most community college students may not need to take out loans, borrowing may enable students to work less and focus more on their studies, take additional classes, and afford important college-related expenses like transportation and child care. In February 2014, the U.S. Department of Education issued a Dear Colleague Letter reminding colleges about the importance of making federal loans available:[9]

> Many students could not afford to attend even low-cost colleges if it were not for the support provided by the Direct Loan Program. Access to federal student financial aid, including low-cost Federal student loans, increases the likelihood that students will have the financial resources to successfully complete the post-secondary education needed to build a better future for themselves, their families, and their communities.

Experts unanimously agree that federal student loans should always be the first line of defense for students who do borrow. This is because federal student loans are much safer than other types of borrowing, such as private education loans, credit cards, or payday loans. Federal student loans have fixed interest rates, flexible and affordable repayment plans, generous forgiveness programs, and important consumer protections, such as deferments for unemployment, active military duty, and economic hardship, and cancellation if the borrower dies or is severely disabled. Private loans made by banks and other lenders, in contrast, are not required to provide such borrower benefits and protections. Private loans also typically have variable interest rates that cost most for those who can least afford them.

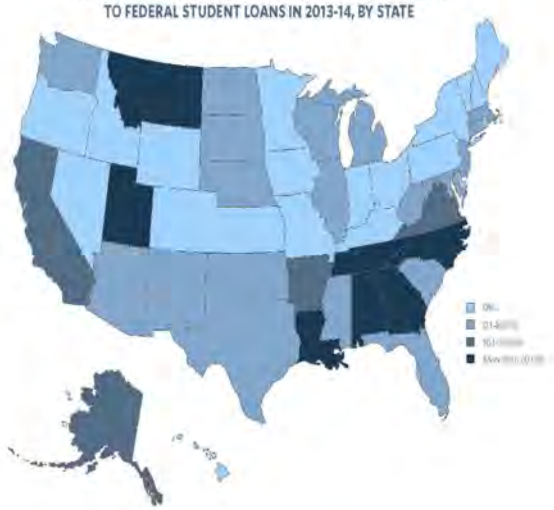
Barring access to federal loans does not keep students from borrowing - it just keeps them from borrowing federal loans. While this policy may be intended to help community college students, it does them a dangerous disservice by intentionally or unintentionally steering them towards riskier and more expensive debt.

2013-14 FINDINGS AND ANALYSIS

Who Lacks Access to Federal Loans?

In 2013-14, there were 30 states in which some community colleges had opted out of the loan program, including seven states in which more than 20 percent of students lacked access. The five states with the lowest rates of access were all in the South. In contrast, the 20 states where all community colleges offered federal student loans were not concentrated in any one region.[10] See map below.

SHARE OF COMMUNITY COLLEGE STUDENTS WITHOUT ACCESS TO FEDERAL STUDENT LOANS IN 2013-14, BY STATE



[9] The U.S. Department of Education, 2014. *Impact of Cohort Default Rates on Institutional Title IV Program Eligibility*, ED Dear Colleague Letters: http://www.ifap.ed.gov/dpcletters/GEN1403.html. Accessed June 30, 2014.

[10] Geographical regions defined using the U.S. Census Bureau American Fact Finder: http://factfinder2.census.gov/help/en/glossary/r/region.htm

Loan Access by Race/Ethnicity

There were substantial differences in federal loan access for students of different racial and ethnic backgrounds.[11] Nationally and across all groups, 8.5 percent of community college students were enrolled in colleges that did not participate in the federal loan program. Of White students in community colleges, 7.5 percent were enrolled in non-participating schools. That share rose to 10.5 percent for Latino students, 12.4 percent for African-American students, and 20.1 percent for Native-American students, the three groups most likely to lack federal loan access. With 4.5 percent attending non-participating colleges, Asian students were the least likely of any racial or ethnic group to lack access to federal student loans.[12]

Within some states the differences in loan access between White and underrepresented minority students were even sharper. For example, in Alabama 34.7 percent of White students attended non-participating community colleges compared to 63.7 percent of their African-American peers, and in Tennessee 37.1 percent of White students lacked federal loan access compared to 58.9 percent of African-American students. In Texas, only 2.7 percent of White students lacked access compared to 13.3 percent of Latino students. And in Alaska, 6.5 percent of White students lacked access compared to 60.1 percent of their Native-American peers.[13]

TABLE 1: COMMUNITY COLLEGE STUDENTS NATIONALLY WHO LACKED ACCESS TO FEDERAL STUDENT LOANS IN 2013-14, BY RACE/ETHNICITY	SHARE	NUMBER[14]
All	8.5%	987,000
White	7.5%	451,000
African American	12.4%	213,000
Latino	10.5%	214,000
Asian	4.5%	29,000
Native American	20.1%	24,000
Other/Unknown[15]	5.3%	56,000

A full table of community college loan access by state and race/ethnicity is on page 16.

Loan Access by Urbanicity

There were also sizeable differences in federal loan access by locale, specifically urban compared to non-urban areas.[16] For purposes of this analysis, we classify all categories of city and suburb as urban areas and all categories of town and rural as non-urban areas.

Across the country, community college students in non-urban areas were more than twice as likely as their urban peers to attend schools that did not offer federal loans, where rates of non-participation were 13.9 percent and 6.4 percent, respectively. About one quarter (27.9 percent) of all community college students attended schools in non-urban areas.

There were also acute differences in loan participation by locale within states. For example, in California, where the statewide non-participation rate was 12.6 percent, students at schools in non-urban areas were almost three times as likely to lack access as their peers in urban areas (27.9 percent vs. 10.1 percent). And while Connecticut had a relatively low statewide non-participation rate of 3.6 percent, more than half (57.0 percent) of students at non-urban community colleges lacked access compared to less than one percent of their peers at urban schools.

States with the highest non-participation rates also tended to have high rates of enrollment in non-urban colleges: among the eleven states where at least ten percent of students lacked loan access, seven had a greater share of students enrolled in non-urban colleges than the national average. However, 14 of the 20 states in which every community college offered loans also had a greater share of students attending non-urban colleges than the national average.

Of states with community colleges located in both urban and non-urban areas, there were eight states where all students who lacked access attended non-urban community colleges[17] and three where all students who lacked access attended urban schools.[18]

A full table of community college loan access by state and urbanicity is on page 18.

[11] For purposes of analyzing access to loans by race/ethnicity in this brief we included the following racial/ethnic categories: African American, Asian (includes Pacific Islander), Latino, Native American, Other/Unknown, and White. See Methodology on page 21.

[12] Unless otherwise noted, throughout this report Asian-American and Pacific-Islander students are categorized as Asian students.

[13] The high rate of non-participation in Tribal Colleges and Universities (TCUs) contributes to the lack of federal student loan access for Native-American students.

[14] Figures are rounded to the nearest 1,000.

[15] Other/Unknown comprises students classified as international and multiracial, as well as students for whom their race/ethnicity is [illegible]

[16] A college's locale is based on its physical proximity to an urbanized area, assigned through a methodology developed by the U.S. Census Bureau's Population Division in 2005. There are four major categories: city, suburban, town, and rural, each with three subcategories. For city and suburb, there are gradations of size – large, midsize, and small. Towns and rural areas are further distinguished by their distance from an urbanized area, and can be characterized as fringe, distant, or remote. Both cities and suburbs are inside an urbanized area (a densely settled core with a population of 50,000 or more), but a city is within a principal city (a primary population and economic center of an MSA – one or more contiguous counties that have a highly populated core area with adjacent communities that are economically or socially integrated with the core) while a suburb is outside of a principal city. Towns are territories inside an urban cluster (core areas with populations between 2,500 and 50,000), and rural encompasses all population, housing, and territory not included within an urban area or urban cluster. For more detail please see: http://nces.ed.gov/surveys/ruraled/definitions.asp and the "degree of urbanization" at http://nces.ed.gov/ipeds/glossary/?charindex=D

[17] These eight states are Arizona, Michigan, Montana, Nebraska, North Dakota, South Carolina, Virginia, and Wisconsin.

[18] These three states are Massachusetts, New Jersey and [illegible]

TABLE 2: FEDERAL STAFFORD AND PRIVATE LOAN TERMS AND BENEFITS FOR 2013-14 AND 2014-15 COMMUNITY COLLEGE STUDENTS

	Subsidized Stafford	Unsubsidized Stafford	Private Loans
Eligibility	Available to undergraduate students with financial need; enrolled at least half time; no credit check; college must participate in the federal loan program	Available to undergraduate students regardless of need; enrolled at least half time; no credit check; college must participate in the federal loan program	Enrollment requirements vary; credit check required, and usually a cosigner
Maximum Annual Amount	$3,500 as freshman; $4,500 as sophomores	For dependent students: $5,500 for freshman (including up to $3,500 subsidized); $6,500 for sophomores (including up to $4,500 subsidized); for independent students and dependent students whose parents are unable to obtain PLUS loans: $9,500 for freshman (including up to $3,500 subsidized); $10,500 for sophomores (including up to $4,500 subsidized)	Typically up to full cost of attendance minus other aid
Interest Rate	Fixed at 3.86% in 2013-14; fixed at 4.66% for the 2014-15 school year		Variable or fixed, no maximum; based on credit and market rates; up to 13% or more in 2014
Fees	1.051% if first disbursed before December 1, 2013; 1.072% if first disbursed on or after December 1, 2013 and before October 1, 2014; 1.073% if first disbursed on or after October 1, 2014 and before October 1, 2015		At lender's discretion
Charges During School	None	Interest accrues	Interest accrues or payments due
Unemployment/ Economic Hardship Policy	No payments required and no interest charged for up to three years of economic hardship/unemployment	No payments required but interest accrues for up to three years of economic hardship/unemployment	Lender discretion; usually very limited, interest accrues, may charge fees
Income-Driven Repayment	Available		Not Available
Public Service Loan Forgiveness	Various provisions for teachers, government, and nonprofit workers		None
Other Cancellations	Death or total and permanent disability; closed school		Death and disability at lender's discretion; none if school closes

For more information about federal student aid, please visit the U.S. Department of Education's http://studentaid.ed.gov

NOTABLE STATE CHANGES

NORTH CAROLINA

In 2010-11, 57.0 percent of North Carolina community college students lacked access to federal loans, the largest share of any state in the country at that time. In 2013-14, 36.0 percent lacked access, but the question for North Carolina is whether the improvement is here to stay.

In North Carolina, this issue has been on a legislative roller coaster in recent years. In 2011, state legislators voted to overturn a year-old requirement – imposed by the prior legislature in 2010 – that all of the state's community colleges offer federal loans. The then-governor vetoed the attempt, keeping the requirement in place. Without enough votes to overturn the veto, smaller groups of legislators banded together to pass a number of veto-proof "local bills" that allowed certain colleges to stop offering loans. Finally, in 2012, legislators overturned the governor's veto, once again enabling all colleges to opt out of offering federal loans.

Confused yet? Imagine how the students feel. While relatively few colleges nationally enter or exit the loan program in any given year, North Carolina stands out for having far more participation status changes than anywhere else. For example, Central Piedmont Community College (CPCC) began offering loans in 2011-12 in response to the state requirement, then made headlines in early 2014 for announcing its upcoming departure from the loan program after just three years.[19]

In explaining the college's decision, Jeff Lowrance, CPCC's Public Information Officer and Assistant to the President, stated that "most of the community colleges in North Carolina have reached the same conclusion as CPCC; the federal Direct loan program puts students and institutions at great risk."[20] However, when CPCC decided to stop offering loans, not enough time had passed for the college's recent borrowers to have had their repayment tracked in a cohort default rate (CDR). And even if it had received a CDR that exceeded sanction thresholds, with a 2012-13 borrowing rate of just 14 percent[21] the college may have been protected from sanctions by making a Participation Rate Index challenge.[22] (For more about CDRs, which measure how many borrowers default within a given time period, and related sanctions see box on page 10; for more on the Participation Rate Index see box on page 12.)

In another college's explanation of its decision to stop offering loans, Dr. Ervin V. Griffin Sr., President and CEO of Halifax Community College in North Carolina, released a memo in June 2013 stating that "the amount of debt students are incurring may exceed the amount they can afford to repay in the future."[23] Yet in the following paragraph, Dr. Griffin states that "the goal of the College is to continue to provide students with access to loans" and that "as an alternative to the Direct Loan program, the College will agree to certify private educational (alternative) loans from any lender the student chooses." This calls into question whether the goal is truly to keep students from borrowing too much, or rather to insulate the college from responsibility if they do. (For more on the risks of private loans compared to federal loans, see page 14.)

Not all North Carolina community colleges agree with that approach. While Guilford Technical Community College (GTCC) is concerned about student borrowing and default rates, it remains committed to offering federal loans.[24] Lisa Koretoff, Director of Financial Aid at GTCC, thinks that a belief that community college students do not need to borrow – one that is at odds with some students' realities – may be at the heart of other colleges' decisions to stop offering loans. Ms. Koretoff, who herself paid for college using a credit card, believes that federal loans are an important option and notes that some programs – like nursing – require that students reduce their work hours or not work at all. Rather than put these students' success at risk by pulling out of the loan program, GTCC is developing strategies to manage its CDR and help students make wise borrowing decisions.

CALIFORNIA

California community college students' access to federal loans continues to decline, with seven more schools in the California Community College (CCC) system dropping out of the loan program since 2010-11.[25] Over the past six years, the number of CCCs that do not offer federal loans has doubled to 22.[26] With more than 250,000 students enrolled in non-participating colleges in 2013-14, California remained the state with the largest number of community college students without

[19] Thomas, [illegible]. March 7, 2014. "CPCC Opts Out of Federal Student Loan Program." *Charlotte Business Journal*. http://www.bizjournals.com/charlotte/news/2014/03/07/cpcc-opts-out-of-federal-student-loan-program.html?page=all. Accessed June 30, 2014.

[20] Ibid.

[21] Information about Central Piedmont Community College from the U.S. Department of Education's College Navigator website is available at http://nces.ed.gov/collegenavigator/?q=central+piedmont&s=all&id=[illegible]#finaid. Accessed June 30, 2014.

[22] When a college contests its CDR or sanction after receiving a draft rate, it is called a challenge. When a college contests its CDR or sanction after receiving an official rate, it is called an appeal. Unless otherwise noted, for ease of understanding we refer to appeals throughout the remainder of the paper.

[23] Halifax Community College. 2013. Memo. "William D. Ford Federal Direct Loans." http://www.halifaxcc.edu/[illegible]/memo.pdf. Accessed June 30, 2014.

[24] Personal communication with Lisa Koretoff, Director of Financial Aid at Guilford Technical Community College, in June 2014.

[25] The seven colleges are College of the Desert, El Camino College, El Camino College – Compton Center, Hartnell College, Victor Valley College, Yuba College, and Woodland Community College. Woodland Community College was not a separate college in our analysis for *Still Denied*, which used the U.S. Department of Education's Integrated Postsecondary Education Data System (IPEDS) 2008-09 data to identify colleges. However, federal loan volume data from the U.S. Department of Education makes clear that the school previously offered loans. Federal Student Aid Data Center. Title IV Program Volume Reports. https://studentaid.ed.gov/about/data-center/student/title-iv. Accessed June 19, 2014.

[26] TICAS. 2009. *Getting with the Program*. http://www.ticas.org/files/pub/getting_with_the_program.pdf. East San Gabriel Valley Regional Occupational Program, which is not a part of the CCC system, also does not offer federal loans, bringing the total number of non-participating community colleges in California to 23.

access to federal loans.[27] Also, for the first time since we began documenting community college participation status by state in 2008, the share of students without access in California was higher than the national share.

Very few community college students in California borrow federal loans: only four percent of undergraduate students at community colleges in California borrowed in 2011-12, compared to 20 percent across the country.[28] But for those California students who do borrow, federal loans are a critical resource. In 2012-13, students in the California Community College system received nearly $300 million in federal student loans, making loans the third largest source of financial aid across the college system.[29]

As in other states, representatives of colleges that have stopped offering federal loans point to concerns about cohort default rate (CDR) sanctions, particularly as the long-feared change to a three-year CDR calculation goes into effect later this year. (For more about CDRs, which measure how many borrowers default within a given time period, and related sanctions see box on page 10.) However, what sets the California colleges apart is that all of the newly non-participating colleges appear to have low enough participation rates to successfully appeal sanctions if their default rates exceed threshold levels.[30] (For more on the Participation Rate Index see box on page 12.)

It is unclear whether these colleges understand that they are not at risk of sanctions. The chancellor of the Yuba Community College District (YCCD), home to Woodland Community College and Yuba College which both recently exited the federal loan program, publicly said district staff could not find sufficient assurance that the colleges could appeal CDR sanctions, should sanctions someday apply.[31] Still, the district acknowledges that some students will need to borrow. YCCD Chancellor Dr. Douglas B. Houston explained that students in certain programs will "have to drop out of the workforce" to attend classes full time, and that "for them, it's going to be a hardship."[32] As such, the district announced that it intended to direct students who need to borrow to Sallie Mae for private loans.[33] While this protects the college from the potential negative repercussions of student borrowing, it directs students towards riskier and more costly private loans.

While individual colleges and districts make decisions about whether to offer loans, the California Community College Chancellor's Office is doing what it can to support colleges in offering loans. In a March 2014 memo to college CEOs, system Chancellor Brice W. Harris underscored the importance of federal loan access:[34]

> Many California community colleges have an average 'net price' for full-time students of more than $10,000 per academic year after grant and scholarship aid is applied. Federal student loans play a significant role in meeting these financial 'gaps' and allowing students to pursue and complete their higher education aspirations.

The Chancellor's Office also launched a default prevention and management initiative last year to help its colleges run successful federal loan programs. Chancellor's Office staff have conveyed interest in reaching out to non-participating colleges as the initiative develops to encourage them to reenter the program.[35]

GEORGIA

Comparing loan access in 2010-11 and 2013-14 paints an incomplete picture of what has been happening in Georgia. Since 2010-11, when 55.1 percent of students lacked loan access, more than a dozen schools began offering loans.[36] However, some of those same schools quickly reversed course and stopped offering loans by 2013-14. So while the share of students without loan access in 2013-14 (26.5 percent) was a clear improvement over 2010-11, it also represents a decline in loan access from the intervening years.[37]

[27] For this report, our definition of community colleges includes both public two-year colleges and public four-year colleges that award primarily associate's degrees and credentials (for more detail, see Methodology on page 21). As such, there are 117 California colleges in our analysis, including all of the colleges in the California Community College (CCC) system and four schools (Beaumont Adult School, Charles A. Jones Career and Education Center, East San Gabriel Valley Regional Occupational Program, and Los Angeles County College of Nursing and Allied Health) that are not a part of the CCC system.

[28] Calculations by TICAS on data from the U.S. Department of Education's IPEDS 2011-12. Unless otherwise noted, calculations on IPEDS data include students attending public two-year colleges only.

[29] Calculations by TICAS using the California Community Colleges Chancellor's Office (CCCCO) Data Mart. http://datamart.cccco.edu/datamart.aspx. Accessed June 18, 2014.

[30] Under current rules, colleges with participation rates under 21 percent may appeal sanctions. The exact data needed to calculate a college's participation rate for the purpose of a CDR sanction appeal are not publicly available, but using the latest available data from the CCCCO Data Mart we estimate that all seven CCCs that recently stopped participating have borrowing rates well below 21 percent. Please note that our estimates are conservative because the borrower count includes all student and parent loans (including a small number of borrowers who may not have federal Stafford loans), and the share of students enrolled at least halftime is as reported on the census date and not the more generous definition that the Participation Rate Index (PRI) challenge and appeal allow (students enrolled at least halftime for one day within a twelve-month period). For more on the PRI challenge and appeal see page 22.

[31] Kalb, Loretta. July 15, 2013. "Yuba Community College District Suspends Federal Student Loan Program." The Sacramento Bee. http://www.sacbee.com/2013/07/15/5566[illegible]/yuba-community-college-district.html#storylink=cpy. Accessed June 20, 2014.

[32] Nicholson, Jeff. August 26, 2013. "Yuba College Giving Students Options for Loans." Appeal Democrat. http://www.appeal-democrat.com/yuba-college-giving-students-options-for-loans/article_d3de6048-[illegible].html?mode=jqm. Accessed June 30, 2014.

[33] Ibid.

[34] Brice W. Harris, State Chancellor 2014. Memo. "First Monday – March 2014." California Community Colleges Chancellor Brice W. Harris.

[35] Personal communication with a representative of the California Community Colleges Chancellor's Office, in September 2013.

[36] Federal loan volume data from U.S. Department of Education, Federal Student Aid Data Center, Title IV Program Volume Reports. https://studentaid.ed.gov/about/data-center/student/title-iv. Accessed July 1, 2014.

[37] Note that we excluded one college (Heart of Georgia Technical College) from our 2013-14 analysis because it was not active in IPEDS 2011-12. In addition, eight other Georgia community colleges (seven of which were technical colleges) in our 2010-11 analysis (using 2008-09 IPEDS data) are not listed separately in our 2013-14 analysis (using 2011-12 IPEDS data) due to mergers. By 2013-14, three more Georgia community colleges (one of which was a technical college) were no longer listed as separate institutions due to mergers. See our list of colleges' participation statuses at http://projectonstudentdebt.org/files/pub/CC_participation_status_2013-14.pdf.

The loan program participation changes in Georgia have been largely driven by changes to Georgia's merit-based HOPE Program (including HOPE Grants and Scholarships) beginning in 2011-12. The changes that year included reducing students' eligibility by increasing merit requirements and reducing the size of eligible students' awards.[38] Concerned about the effect of these changes on their students' ability to pay for college, and to help students fill the newly created gap, 15 more Technical College System of Georgia (TCSG) schools began to offer federal loans.[39]

In 2013-14, the Georgia State General Assembly reset the minimum GPA required for a HOPE Grant from 3.0 to 2.0, restoring eligibility for many students.[40] This change was made in the wake of TCSG enrollment dropping dramatically when the minimum GPA had increased: between 2011 and 2012, the number of full-time equivalent students in the technical college system dropped 24 percent.[41]

By 2013-14, some newly participating colleges began to express concerns about higher than expected borrowing and delinquency rates (none had been participating long enough to have had recent borrowers' repayment tracked in a cohort default rate (CDR)). That year, five TCSG colleges, including Southern Crescent Technical College (SCTC), stopped offering loans.[42] In a May 2013 notice, SCTC President Randall Peters expressed concerns that some graduates' loan payments - if debt outpaces later earnings - may become a burden, stating that "this is a potential financial nightmare that our students do not want or need. I honestly do not want to put our students in a situation that creates this type of financial hardship."[43] However, colleges can help students borrow wisely, and struggling federal loan borrowers can opt for repayment plans that base their payments on their incomes.[44] Further, with a net price of almost $10,000 - close to $1,400 more than nearby public four-year Gordon State College - some SCTC students will likely need to borrow to cover the gap between college costs and available grants.[45] For those students, federal loans are the safest and most affordable option.

Some TCSG schools take a different approach. For example, Kenneth Wilson, Director of Financial Aid at Albany Technical College - where 55 percent of undergraduates borrowed federal loans in 2012-13[46] - believes that many students are able to attend full time as a result of borrowing.[47] Mr. Wilson credits several practices with helping students borrow wisely and keeping defaults down. Loans are disbursed in two installments per term, and Mr. Wilson notes that borrowers are learning how to better manage their money. There is also a school-wide database where faculty track attendance and record mid-term grades. If the financial aid office sees that a borrower has withdrawn or is failing courses, immediate steps are taken to communicate with the student. And the school's default management committee attends nearly every event on campus, from basketball games to picnics, handing out information on student loan repayment. Accordingly, the college has seen its default rate drop in recent years, from 28.0 percent in FY 2009 to 23.1 percent in FY 2010, and to a projected rate below 20 percent for FY 2011.[48]

Another reason that Georgia community colleges may be leaving the federal loan program is because the state has created two new private loan programs that do not hold colleges accountable in the same way as the federal loan program. In response to the HOPE Program cuts in 2011-12, the legislature that year funded a $20 million Student Access Loan (SAL) Program for the state's students.[49] And this upcoming fall, another new loan - the Student Access Loan-Technical (SALT) Program - will be available exclusively to Georgia's technical college students. Both SAL and SALT require monthly "Keep In Touch" payments, and have a one percent interest rate - except if borrowers default. Then the rate irrevocably converts to five percent for the life of the loan. Forbearance, deferment, and forgiveness options are available in certain circumstances, including for those who choose public service or STEM careers after they graduate (SAL borrowers only).[50]

Technical college students, who have had access to SAL since it became available in 2011-12, now must first exhaust their SALT eligibility, which has lower annual and lifetime limits than SAL: $3,000 compared to $10,000, and $12,000 compared to $40,000, respectively. While SALT may help some students

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[38] The Georgia Budget & Policy Institute. December 21, 2012. Blog post. "Changes to HOPE: Bad for Georgia's Future?" [illegible] Accessed June 30, 2014.

[39] Personal communications with Holly Bates, Student Affairs Coordinator at the Technical College System of Georgia (TCSG), and Judith Witherspoon, Senior Vice President at Edfinancial Services, in May and June 2014.

[40] Georgia Budget & Policy Institute. 2014. *Overview: 2015 Fiscal Year Budget for Lottery-Funded Programs: Funding for Pre-Kindergarten and HOPE Falls Short of Students' Needs.* [illegible]Overview-2015-Fiscal-Year-Budget-for-Lottery-Funded-Programs.pdf

[41] Ibid.

[42] Personal communication with Holly Bates, Student Affairs Coordinator at TCSG in May and June 2014.

[43] Southern Crescent Technical College. 2013. News. "SCTC Plans to Discontinue the Student Loan Program." http://www.sctech.edu/news/. Accessed June 30, 2014.

[44] For more information on income-driven repayment plans, see [illegible]

[45] The net price of college is the total cost of college minus available grants and scholarships. In 2012-13, the net price for students attending SCTC was $9,650 and the net price for students attending Gordon State College was $8,282. Net price figures are reported by colleges to the U.S. Department of Education.

[46] Information about Albany Technical College from the U.S. Department of Education's College Navigator website is available at [illegible] Accessed July 7, 2014.

[47] Personal communication with Kenneth Wilson, Director of Financial Aid at Albany Technical College, in May 2014.

[48] FY 2009 and FY 2010 three-year CDRs available at the U.S. Department of Education, Federal Student Aid, Official 3-Year Cohort Default Rate Search: [illegible] Accessed June 30, 2014. FY 2011 three-year CDR based on personal communication with Kenneth Wilson, Director of Financial Aid at Albany Technical College, in May 2014.

[49] SAL loans are funded at $19 million for FY 2014-15 per Georgia House Bill 744, signed by Governor Nathan Deal on April 28, 2014: [illegible]/2015_FiscalYear/FY_2015_Bill_Gov_Signed.pdf

[50] Georgia Student Finance Commission. 2014. *Student Access Loan Technical Program Regulations - 5300: 2014-15 Award Year.* [illegible] and Georgia Student Finance Commission. 2014. *Student Access Loan Program Regulations - 5100: 2014-15 Award Year.* [illegible]

afford technical college costs, it is not clear whether its funding level ($10 million for 2014-15)[51] will cover all eligible applicants – less than half of students who applied for assistance through the already existing SAL program received a loan.[52] Additionally, unlike federal loans, SAL and SALT do not offer income-driven repayment plans, which tie borrowers' monthly payments to a reasonable share of their income.[53] This option is especially critical when borrowers are struggling to find enough work to pay their bills, and gives borrowers the peace of mind of a safety net should their financial situation deteriorate.

While these state loan programs were clearly expected to supplement and not replace federal loans for needy students, their existence may remove an incentive for colleges to offer federal loans. That is because, while federal loans hold both students and colleges accountable, the SAL and SALT programs do not hold colleges accountable when students default. As such, Georgia colleges that understand students need loans, but do not want to be responsible for defaults, can have it both ways: the state loan programs provide students loan access without asking colleges to help students make wise borrowing decisions and stay on track in repayment. While it is clear why colleges might find this appealing, it is far less clear how students fare. The Georgia Student Finance Commission does not publish SAL Program delinquency or default rates.[54]

Also concerning, the independent, nonpartisan Georgia Budget & Policy Institute (GBPI) has reported that "an overwhelming number of participants in the low-interest Student Access Loan Program are from low-income households."[55] This is particularly troubling given that low-income college graduates are already much more likely to borrow, and graduate with more student loan debt, than their higher income peers.[56] Given that the SAL and SALT programs are not intended to supplant federal loans, this raises questions about whether these programs are even further indebting low-income students. GBPI has recommended the funding for these loans instead be put towards a need-based grant program to minimize students' need to borrow.[57]

WHY DO COLLEGES OPT OUT?

When leaving the loan program, community college representatives typically cite their perceived inability to keep students from borrowing unnecessarily or to influence whether those borrowers repay their loans. While concerns about appropriate borrowing and student loan defaults are understandable given the severe consequences of default for both students and institutions, it is simply not the case that there is nothing colleges can do to help students borrow wisely

[51] SALT loans are funded at $10 million for FY 2014-15 per Georgia House Bill 744, signed by Governor Nathan Deal on April 28, 2014: http://www.house.ga.gov/budget/Documents/2015_FiscalYear/FY_2015_Bill_Gov_Signed.pdf

[52] Georgia Budget & Policy Institute. 2014. *Overview: 2015 Fiscal Year Budget for Lottery-Funded Programs: Funding for Pre-Kindergarten and HOPE Falls Short of Students' Needs.* http://gbpi.org/wp-content/uploads/2014/01/Overview-2015-Fiscal-Year-Budget-for-Lottery-Funded-Programs.pdf.

[53] Currently, there are four types of income-driven repayment plans available to federal student loan borrowers. Income-contingent repayment generally caps monthly payments at 20% of borrowers' discretionary income, and forgives remaining loan balances after 25 years. Classic income-based repayment (IBR) allows borrowers with a partial financial hardship to cap monthly payments at 15% of discretionary income, with forgiveness after 25 years. 2014 IBR and Pay As You Earn cap monthly payments at 10% of discretionary income for borrowers with a partial financial hardship, with forgiveness after 20 years. For more information on income-driven repayment plans, see http://studentaid.gov/idr

[54] Personal communication with Jonathan Stroble, Senior Manager, External Affairs at the Georgia Student Finance Commission, in June 2014. The SALT program will begin in fall 2014.

[55] Georgia Budget & Policy Institute. 2012. *Hope on a Tightrope.* http://gbpi.org/wp-content/uploads/2012/10/HOPE-on-a-Tightrope.pdf

[56] TICAS. 2014. *Quick Facts about Student Debt.* http://projectonstudentdebt.org/files/pub/Debt_Facts_and_Sources.pdf

[57] Georgia Budget & Policy Institute. 2012. *Hope on a Tightrope.* http://gbpi.org/wp-content/uploads/2012/10/HOPE-on-a-Tightrope.pdf.

TABLE 3: STAFFORD LOAN USAGE BY COMMUNITY COLLEGE STUDENTS IN 2011-12

	Share of *students* who borrowed Stafford loans	Share of *students* who took out their annual maximum Stafford loan	Share of *borrowers* who took out their annual maximum Stafford loan
All students	17%	7%	43%
Dependent students	14%	5%	37%
Independent students	19%	9%	46%
Full-time students	23%	9%	40%
Dependent students	19%	7%	36%
Independent students	27%	12%	43%
Part-time students	19%	8%	45%
Dependent students	14%	5%	38%
Independent students	22%	11%	47%

Source: Calculations by TICAS on data from the U.S. Department of Education's NPSAS:12. Full-time students are defined as those who attended public two-year colleges exclusively full-time in 2011-12. Part-time students are defined as those who atteded half-time or more at least part of the year. Less-than-half-time students, who are not eligible for Stafford loans, are included in the figures for all students, but not in the figures for full-time or part-time students. While 7% of community college students borrowed their individual annual Stafford maximum, 70% borrowed less than their maximum, and for 23% their maximum could not be determined. While 43% of Stafford borrowers at community colleges borrowed their individual annual Stafford maximum, 56% borrowed less than their maximum, and for 1% their maximum could not be determined.

and repay their loans on time.

Are Students Borrowing Too Much?

Despite unprecedented attention to increasing student loan debt, national data are clear that few community college students borrow loans, and a minority of community college completers has student loan debt. In 2011-12, only 17 percent of all community college students borrowed federal student loans, and 37 percent of those graduating with an associate's degree had borrowed over the course of their undergraduate career.[53]

Similarly, while annual loan limits can sound high compared to the relatively low tuition at community colleges, few students borrow that much (see 2013-14 loan terms and limits on page 5). Even among those who do borrow, only a minority borrows the maximum despite non-tuition community college costs being similar to those at other institutions. (See Table 3 on previous page.)

Are Defaults Avoidable?

To measure how many of their federal student loan borrowers default within a certain period of time after entering repayment, colleges annually receive a "cohort default rate" (CDR) from the U.S. Department of Education. Particularly when a significant share of students at a college borrow, CDRs are a useful and important accountability measure that help indicate whether students are leaving college with debt they cannot repay. Borrowers are considered to have defaulted after 270 days of nonpayment, though they are not counted in colleges' default rates until 360 days of nonpayment. When too many of their borrowers default, colleges can be sanctioned and lose the ability to offer federal loans or Pell Grants to their students.

Concerns about CDR sanctions are heightened in 2014 because it is the first year that sanctions will be based on three-year CDRs. In 2008, Congress changed the CDR to measure the defaults that occur within a three-year rather than a two-year period of time. Implementation of this change was delayed to give colleges several years' notice to adjust to the new, longer CDR window. Beginning in 2014, colleges with cohort default rates of 30 percent or above for three consecutive years can lose the ability to disburse federal loans and federal Pell Grants, the largest source of grant aid available to students.[54] As both colleges and students rely on Pell Grants to help cover costs, such a loss would be devastating. Additionally, any college with a single year's CDR above 40 percent loses the ability to offer federal loans, but retains Pell Grant eligibility. (For more about CDRs, which measure how many borrowers default within a given time period, and related sanctions see box to the right.)

COHORT DEFAULT RATES 101

What is default?
A borrower defaults on a federal student loan after not making any payment for 270 days, though she is not counted in a college's default rate until 360 days of nonpayment. This can only occur after a student graduates or is no longer enrolled in college at least half time, and after a six-month grace period between the end of school and the start of repayment.

What is a cohort default rate?
A cohort default rate measures the share of borrowers who enter repayment in a given year and who default within three years of entering repayment. For the majority of institutions, 2011 cohort default rates are calculated using the equation:

# of borrowers who entered repayment in 2011 and defaulted in 2011, 2012, or 2013 ÷ # of borrowers who entered repayment in 2011 = 2011 Cohort Default Rate

Why do default rates matter?
Institutions with high default rates may face serious sanctions.

DEFAULT RATE	SANCTION
30% or higher in three consecutive years	Potential loss of Stafford loan eligibility and Pell Grant eligibility for three years
Higher than 40% in one year	Potential loss of Stafford loan eligibility for three years

The fear of sanctions due to high CDRs is understandable, but high CDRs are avoidable. A college's demographics are not its destiny, as Albany Technical College (discussed in more detail on page 8) demonstrates. Through the implementation of comprehensive default management strategies, the college has been able to reduce its default rate by more than eight percentage points in two years while serving an increasingly high-need, low-income population.

Indeed, colleges of all types have successfully implemented a variety of strategies to ensure that their students borrow wisely, and that borrowers understand their obligations and loan

[53] Calculations by TICAS on data from the U.S. Department of Education's NPSAS:12.
[54] Federal Pell Grants, available to full- and part-time students, provided up to $5,645 in need-based financial aid in 2013-14. The vast majority of recipients have family incomes of [illegible]

repayment options.[60] Income-driven repayment plans that cap monthly payments at a reasonable share of borrowers' income can also help in reducing defaults and have been available to all federal student loan borrowers since 2009.[61] (See more about what colleges can do on page 12.)

In addition, many community colleges have another important but little-known protection against CDR sanctions. Colleges where borrowing rates are low, and where CDRs may not be broadly indicative of institutional quality or student outcomes, are able to appeal any sanctions that would otherwise apply based on CDRs. Hundreds of community colleges have borrowing rates low enough to be able to benefit from such an appeal, known as the Participation Rate Index. (See Appendix: *Participation Rate Index Worksheet* on page 22 for a template that schools can use to help determine if they are eligible for such an appeal.) However, few are aware of the protection because their default rates have long been below sanction levels and appeals have not been needed.

COHORT DEFAULT RATE APPEALS

Once institutions are notified of their initial calculated cohort default rate, they can appeal any potential rate sanctions based on certain mitigating circumstances, such as serving predominately low-income students or by having just a few students borrowing each year. Details about the types of appeals available can be found in the Cohort Default Rate Guide published by the U.S. Department of Education's Default Prevention and Management department. The U.S. Department of Education does not publish records of the number or types of challenges, adjustments, or appeals requested by institutions.

The *Participation Rate Index appeal* holds particular promise for community colleges (see box on page 12). Given low rates of borrowing, many currently participating community colleges would be eligible to file a Participation Rate Index appeal if their default rates rise.

Also, while all colleges can and should work to minimize the share and number of borrowers who default given the stakes for students, very few community colleges have reason to fear imminent sanctions, and many colleges that stopped offering loans (including those discussed on pages 6,7, and 8) are not close to sanction thresholds. For federal student loan borrowers who entered repayment in 2010, 20.9 percent from community colleges had defaulted within three years – a rate that has grown in recent years but remains more than 9 percentage points below sanction levels.[62] Among individual community colleges, a very small share had CDRs at or above the 30 percent sanction threshold, and an even smaller share of them had CDRs at or above 30 percent for consecutive years. Some of those with the highest CDRs would be able to appeal sanctions based on their low borrowing rates.[63] (For more about CDRs and related sanctions, see box on page 10; for more about the Participation Rate Index, see box on page 12.)

In other words, community colleges are right to be concerned about whether students are borrowing and defaulting unnecessarily, but they are wrong to believe that their only option is to stop offering loans. In some cases, ceasing to offer loans might not even help; colleges can still face sanctions based on too-high CDRs even after they drop out of the loan program, if too many of their former students who previously borrowed eventually default. In contrast, developing thoughtful and appropriate loan practices as so many colleges, including community colleges, have already done will help current and former borrowers alike make wise borrowing decisions and avoid default – as well as protect students' access to aid.

MYTH	REALITY
One bad year and our students will lose their Pell Grants.	Colleges can only lose access to Pell Grants after three consecutive years of high default rates that are not successfully appealed.
Our default rate is close to 20% – we're in trouble!	A college with a 20% default rate is not at risk of sanction.
If we offer loans to some students, we'll have to give them to everyone.	Financial aid offices have the authority to limit or deny federal loan eligibility on a case-by-case basis.
Our students are all high-risk, so we won't be able to prevent a high default rate.	Default management strategies work, and the U.S. Department of Education will work with colleges to address default concerns.
Our default rate is skewed by our low number of borrowers and jeopardizes student access to Pell Grants.	Institutions with low borrowing rates are protected by law from unfair sanctions.

[60] There are many publications highlighting effective strategies. For example, see TICAS. 2012. *Making Loans Work: How Community Colleges Support Responsible Student Borrowing.* http://projectonstudentdebt.org/files/pub/Making_Loans_Work.pdf; Chitty, Haley. 2010. *A Blueprint to Lower Default Rates: Default aversion and degree completion challenges.* University Business Solutions for Higher Education Management Articles. http://www.universitybusiness.com/article/blueprint-lower-default-rates. Accessed June 30, 2014; Dillon, Erin and Robin V. Smiles. 2010. *Lowering Student Loan Default Rates: What One Consortium of Historically Black Institutions Did to Succeed.* Education Sector. http://www.educationsector.org/publications/lowering-student-loan-default-rates. Accessed June 30, 2014; Texas Guaranteed Student Loan Corporation. 2000. *Shoulder to Shoulder: The Progress Made by the Texas Student Financial Aid Community in Preventing Defaults.* http://www.tgslc.org/pdf/shoulder.pdf; and The Texas Historically Black Colleges and Universities Default Management Consortium. 2004. *Breaking New Ground.* http://www.tgslc.org/pdf/hbcu.pdf.

[61] TICAS. June 30, 2009. Press release. "New Federal Income-Based Repayment Plan Goes into Effect July 1." http://ticas.org/files/pub/July_1_IBR_Alert.pdf.

[62] U.S. Department of Education. 2013. *Comparison of 3-Year FY 2010 Official Cohort Default Rates to Prior Official Calculations.* [illegible] Figures from this source refer to public 2-3-year colleges.

[63] U.S. Department of Education. Official Three-year Cohort Default Rates. [illegible] Accessed July 1, 2014. Figures from this source refer to public 2-year colleges.

PARTICIPATION RATE INDEX, BY THE NUMBERS

A college's federal student loan participation rate is the share of its eligible students who actually borrow. The Participation Rate Index is the participation rate multiplied by the institution's default rate. The Higher Education Opportunity Act increased the maximum Participation Rate Index that protects schools from sanctions based on CDRs for fiscal years beginning October 2011.

Currently, a school where less than 21 percent of eligible students borrow can use the Participation Rate Index appeal. The Participation Rate Index must be 0.0625 or less for three-year sanctions, or 0.0832 or less for one-year sanctions.

Here is an example:

College A has 2,500 students who are eligible to borrow federal loans, and 400 borrowers. The college's most recent default rate is 35 percent.

400/2,500 x .35 = 0.056

College A could appeal based on its Participation Rate Index and avoid sanctions.

WHAT COLLEGES CAN DO

Colleges are required by law to ensure that federal student loan borrowers complete loan entrance and exit counseling, but otherwise little else is required of colleges in terms of counseling and outreach to borrowers. However, colleges can do much more. Financial aid offices have great flexibility in tailoring information, outreach, and counseling to best suit their students' needs, including education on both the benefits and risks of borrowing.

The U.S. Department of Education provides many publications to help financial aid administrators design and implement their own debt management plans, which need not be limited to the federally required entrance and exit counseling. While many schools see loan counseling and default management as the sole responsibility of the financial aid office, entire institutions rely on federal aid and should take part in serving students well. To maximize their effectiveness, default management plans need to involve the entire campus. For instance, faculty know which students are missing class or falling behind, and can alert the financial aid office. When academic and financial aid counselors work together closely they can more easily advise students and design appropriate interventions when needed.

Participating colleges have also successfully employed policies and practices to help their students borrow wisely:

- At Santa Rosa Junior College in California, potential borrowers must fill out a "Worksheet for Student Borrowers," which asks about educational and career goals, plans for graduation or transfer, existing student loan debt, expected annual salary after graduation, and amount of approximate annual loan payments. Potential borrowers must also fill out a detailed student budget worksheet, and a multi-year plan to think through how much they intend to borrow - and when - before reaching their academic goal. These forms are designed to help students learn about annual and aggregate borrowing limits, as well as availability of other types of aid and how these relate to their academic plans.[64]
- The Virginia Community College System requires students to take a "student development" course, which was initiated based on legislation requiring colleges to offer courses on "student life skills." The legislation specifically mentioned financial literacy principles related to "completing a loan application" and "managing student loans." In recent years, a state task force recommended that an online tool called the "Virginia Education Wizard" be included in all of these courses. One component of the Wizard is explicitly focused on college finances and financial aid. It also offers information to help students estimate their living expenses and future salaries.[65] In the 2013-14 Planning Supplement of its Strategic Plan, Tidewater Community College (TCC) in Virginia discussed its intent to continue "to promote the Virginia Education Wizard as a career and college planning tool for TCCs diverse student body." The supplement reports that TCC has already strengthened the use of the Wizard in on-campus pre-enrollment orientation and incorporated it into its online orientation program.[66]
- Financial aid administrators always have the ability to exercise professional judgment when appropriate. If a counselor feels that a particular student is too much at risk of future default to take out a loan, the counselor can limit or deny the funds so long as she documents legitimate reasons for doing so.

[64] TICAS. 2012. *Making Loans Work: How Community Colleges Support Responsible Student Borrowing.* http://projectonstudentdebt.org/files/pub/Making_Loans_Work.pdf.

[65] Ibid.

[66] Tidewater Community College. 2013. *The Tidewater Community College Strategic Plan 2013-14 Planning Supplement.* http://www.tcc.edu/welcome/tcc/[illegible]/2013-14_[illegible]_Planning_Supplement[illegible]

Participating colleges have successfully employed policies and practices to help their students once they have borrowed:

- Seven historically black colleges and universities (HBCUs) in Texas formed a default management consortium in 1998, which helped reduce these colleges' CDRs in subsequent years. Strategies employed included the formation of an oversight taskforce of faculty, staff, and administrators, and the implementation of default management plans that incorporated borrower education, communication, and data analysis.[67] Other practices included establishing one-on-one contact with at-risk borrowers, making exit counseling a requirement for students to participate in graduation ceremonies, and coordinating efforts with outside groups such as churches and chambers of commerce.[68]

- Yet another successful practice colleges have employed is coordinating the financial aid office with other student services professionals and faculty to make students' academic success the top priority. One strategy is the use of early warning systems to identify students in danger of not meeting Satisfactory Academic Progress (SAP) standards. Antelope Valley College in California requires students to meet with a counselor when they have earned 70 units to make sure they have a clear education plan and submit an explanation of their plan for finishing their degree or transferring. Mendocino College in California engages in similar interventions once students hit 60 units.[69]

- Counseling and outreach strategies can make a substantial difference in college default rates. As discussed on page 8, Albany Technical College reduced its default rate by more than eight percentage points in two years by developing counseling and outreach strategies geared towards its student body. National Park Community College in Arkansas did the same, lowering its default rate eight percentage points in two years by improving its financial aid administrative policies, including loan counseling, and dedicating more staff time to educating delinquent borrowers about their repayment options.[70]

Dr. David Volpe recently joined South Louisiana Community College (SLCC), a non-participating college in 2013-14, from Pennsylvania Highlands Community College, a participating college, to become SLCC's Vice Chancellor of Student Services. Under his guidance, SLCC will offer federal loans in 2014-15. Dr. Volpe believes that the benefits of offering federal loans are clear so long as the program is administered wisely, and that it's "absolutely possible to manage a college's cohort default rate."[71] He says his college's decision to offer federal loans isn't about getting more students in seats, but about serving students the best way the college can and making available the resources students need to succeed.

[67] Texas Guaranteed Student Loan Corporation. 2011. *Taming the Default Rate Beast*. http://www.tgslc.org/pdf/Taming-default-rate-beast.pdf.

[68] Dixon, Edward and Robin V. Smiles. February 2010. *Lowering Student Loan Default Rates: What One Consortium of Historically Black Institutions Did to Succeed*. Education Sector.

[69] TICAS. 2012. *Making Loans Work: How Community Colleges Support Responsible Student Borrowing*. http://projectonstudentdebt.org/files/pub/Making_Loans_Work.pdf.

[70] "NPCC's 3yr Cohort Default Rate Crisis," Fall 2013 presentation at the Louisiana Association of Student Financial Aid Administrators. http://www.lasfaa.org/docs/conference/Fall2013/handouts/NPCC3yrCohortDefaultRateCrisis.pdf. Accessed June 30, 2014.

[71] Personal communication with Dr. David Volpe, Vice Chancellor of Students Services at South Louisiana Community College, in June 2014.

PRIVATE LOANS

Private loans are one of the riskiest ways to finance a college education. Like credit cards, they typically have variable interest rates, and whether variable or fixed the rates are highest for those who can least afford them — as high as 13 percent in June 2014.[72] Additionally, private loans do not have the important deferment, income-based repayment, or loan forgiveness options that come with federal student loans, and are much harder than other forms of consumer debt to discharge in bankruptcy. Experts agree that students and families should exhaust all of their federal aid options before even considering private loans.

Overall, a very small share of community college students (2 percent) borrow private loans. While we do not know what share of community college private loan borrowers attended non-participating schools, nearly three in four (73 percent) borrowed less than they could have in federal Stafford loans before turning to private loans, compared to less than half of private loan borrowers at other schools.[73]

Community colleges - both those that offer federal loans and those that do not - have varying attitudes towards private loans. Many do not mention private loans on their website at all. Of those that do mention private loans, some clearly discourage private loan borrowing. The City Colleges of Chicago, which offer federal loans, even have a policy of not certifying private loans in lieu of federal loans.[74] (See screenshot below.)

Similarly, Independence Community College in Kansas, which offers federal loans, states that it does not "endorse, promote, or certify private student loans",[75] and the Ivy Tech Community College system in Indiana includes a link to "a list of reasons why federal student loans are usually a better option than private (alternative) loans."[76]

Other colleges' approaches range from stating more generally that private loans can be used as an additional resource to prominently listing private loans as if they were a form of financial aid and even directing students to specific lenders. For example, as with the non-participating college example shown on the following page, it is unclear whether these "preferred lender lists" comply with federal law: colleges are required to disclose, among other things, the criteria under which the listed lenders were selected and students' right to choose a lender not

CITY COLLEGES OF CHICAGO'S PRIVATE LOAN POLICY

Private Education Loan Certification Policy and Disclosures

The City Colleges of Chicago does not maintain a preferred lender list for private student loans, nor does it maintain any other lists of lenders. We encourage students to pursue federal and state financial aid and actively discourage the borrowing of private student loans.

CCC will not certify a private education loan unless the student is not receiving enough financial aid to cover the direct cost of attendance (tuition and fees and books). At the Director of Financial Aid's discretion, students in CCC's signature programs (for example, Nursing, French Pastry 16 or 24 week program, or Physician's Assistant) may be certified for a private student loan beyond the direct cost of attendance. A CCC student who is not in a signature program can only receive a private loan up to his/her direct cost of attendance minus other financial aid. CCC will not certify a private loan in lieu of a Federal Direct Loan. Additionally, a student cannot receive a private student loan if he/she is not in good standing per CCC's academic standing policy.

[72] TICAS. 2014. *Private Loans: Facts and Trends.* http://projectonstudentdebt.org/files/pub/private_loan_facts_trends.pdf.

[73] Calculated by TICAS using the U.S. Department of Education's NPSAS:12. While 73% of private loan borrowers took out less than they were eligible for in Stafford loans, 23% reached their individual annual and/or cumulative Stafford limit or were ineligible for Stafford loans because they attended less than half time, and eligibility cannot be determined for the remaining 3% of borrowers. Individual borrowers' Stafford eligibility for 2011-12 varied by class level, dependency status, and college costs after financial aid. Figures do not add up to 100% due to rounding.

[74] City Colleges of Chicago. Private Education Loan Certification Policies and Disclosures. http://www.ccc.edu/colleges/washington/services/Pages/Private-Education-Loan-Certification-Policy-and-Disclosures.aspx. Accessed July 7, 2014.

[75] To learn about TICAS' work to require private education lenders to obtain school certification prior to disbursing private educations loans, see our June 2013 letter to Richard Cordray, Director of the Consumer Financial Protection Bureau: http://www.ticas.org/files/pub/6_17_13_Cordray_Letter.pdf. As a part of the school certification process, students should be informed about their remaining federal loan eligibility before turning to alternative forms of borrowing.

[76] Ivy Tech Community College. http://www.ivytech.edu/financial-aid/loans/. Accessed July 1, 2014.

on the list. (Note: The name of this college has been redacted because the college removed its list of private lenders after being alerted to the problem.)

Despite the widespread recognition that private loans can be a dangerous and expensive way to finance a college education, we came across at least 20 non-participating colleges that prominently list specific banks and lenders offering private loans.[77] These schools clearly acknowledge that some of their students will need to borrow, yet steer them directly to risky private loans instead of providing access to safer federal loans. Offering private loans in lieu of federal loans holds appeal to colleges because they bear no responsibility if borrowers default on private loans, unlike with federal loans. And in addition to the risks of borrowing private loans, not offering federal loans means that colleges have little incentive to help students wisely and navigate the different types of loans available to them.

EXAMPLE OF NONCOMPLIANT PRIVATE LENDER LIST

Home / Financial Aid Office / Types of Financial Aid / Alternative Loan Programs

[redacted]

Special Eligibility Requirements:
Applicants must:
> Be taking at least 6 credits
> Demonstrate unmet financial need

How To Apply:
> To be considered for an Alternative Loan, you must complete the Free Application for Federal Student Aid (FAFSA)
> Must be admitted to [redacted] as a matriculated student.
> Must apply directly though a lender and obtain a pre-approval

SallieMae Smart Option Student Loan

1-866-972-5004 *(Click here to view brochure)*
Special Eligibility Requirements: Applicants must:
> Be taking at least 6 credits
> Demonstrate unmet financial need

How To Apply:
> To be considered for an Alternative Loan, you must complete the Free Application for Federal Student Aid (FAFSA)
> Must be admitted to [redacted] as a matriculated student.
> Must apply directly though a lender and obtain a pre-approval

Wells Fargo Collegiate® Loan

1-800-378-5526
Special Eligibility Requirements: Applicants must:
> Be taking at least 6 credits
> Demonstrate unmet financial need

How To Apply:
> To be considered for an Alternative Loan, you must complete the Free Application for Federal Student Aid (FAFSA)
> Must be admitted to [redacted] as a matriculated student.
> Must apply directly though a lender and obtain a pre-approval

Chase Select SM Certified Private Education Loan

1-866-306-0868
Special Eligibility Requirements: Applicants must:
> Be taking at least 6 credits
> Demonstrate unmet financial need

How To Apply:
> To be considered for an Alternative Loan, you must complete the Free Application for Federal Student Aid (FAFSA)
> Must be admitted to [redacted] as a matriculated student.
> Must apply directly though a lender and obtain a pre-approval

[77] Our search for private loan information on community college websites was not exhaustive. For examples of community college websites that clearly promote private loans, see http://projectonstudentdebt.org/ccwebsites_2014vp.html

TABLE 4: SHARE OF STUDENTS WITHOUT ACCESS TO FEDERAL STUDENT LOANS IN 2013-14, BY RACE/ETHNICITY							
STATE	TOTAL SHARE WITHOUT ACCESS	WHITE	AFRICAN AMERICAN	LATINO	ASIAN	NATIVE AMERICAN	SHARE OF STATE'S COLLEGE STUDENTS AT COMMUNITY COLLEGES
Alabama	42.7%	34.7%	63.7%	--	--	--	36.8%
Alaska	19.8%	6.5%	--	--	--	60.1%	5.4%
Arizona	5.5%	5.3%	2.0%	2.8%	--	--	37.4%
Arkansas	12.7%	11.2%	16.4%	--	--	--	43.0%
California	12.6%	11.6%	15.9%	16.1%	6.5%	--	64.6%
Colorado	0.0%	--	--	--	--	--	38.1%
Connecticut	3.6%	5.0%	0.6%	2.2%	--	--	37.1%
Delaware	0.0%	--	--	--	--	--	33.8%
Florida	6.6%	7.2%	8.7%	5.5%	--	--	45.6%
Georgia	26.5%	30.7%	23.1%	--	--	--	40.4%
Hawaii	0.0%	--	--	--	--	--	50.5%
Idaho	0.0%	--	--	--	--	--	18.2%
Illinois	6.5%	6.9%	10.5%	1.8%	--	--	60.1%
Indiana	0.0%	--	--	--	--	--	36.3%
Iowa	0.0%	--	--	--	--	--	30.1%
Kansas	0.0%	--	--	--	--	--	51.2%
Kentucky	0.0%	--	--	--	--	--	44.4%
Louisiana	44.1%	52.2%	43.0%	--	--	--	37.9%
Maine	0.0%	--	--	--	--	--	31.2%
Maryland	6.7%	3.9%	12.8%	2.1%	3.1%	--	48.4%
Massachusetts	2.7%	0.4%	10.1%	3.0%	--	--	29.8%
Michigan	0.3%	0.1%	0.0%	--	--	--	45.8%
Minnesota	0.0%	--	--	--	--	--	42.6%
Mississippi	9.5%	5.2%	15.1%	--	--	--	54.4%
Missouri	0.0%	--	--	--	--	--	31.3%
Montana	21.9%	3.4%	--	--	--	85.1%	23.8%
Nebraska[78]	0.3%	0.0%	0.0%	0.0%	--	--	50.1%
Nevada	0.0%	--	--	--	--	--	50.4%
New Hampshire	0.0%	--	--	--	--	--	27.1%
New Jersey	6.4%	1.2%	20.0%	8.7%	3.4%	--	47.9%
New Mexico	3.2%	1.9%	--	1.1%	--	15.1%	62.5%
New York	0.0%	--	--	--	--	--	32.8%
North Carolina	36.0%	39.7%	31.5%	--	--	--	53.1%
North Dakota	4.4%	0.4%	--	--	--	63.7%	25.5%
Ohio	0.0%	--	--	--	--	--	41.6%
Oklahoma	8.6%	8.8%	7.8%	11.5%	--	8.6%	45.0%

[78] Native Americans in Nebraska made up just one percent of community college students in the state, so they are excluded from the chart above. However, over 250 Native-American community college students (and a very small number of other community college students) lack access to federal loans, enough to bring the overall non-participation rate to 0.3% when rounded.

TABLE 4: SHARE OF STUDENTS WITHOUT ACCESS TO FEDERAL STUDENT LOANS IN 2013-14, BY RACE/ETHNICITY

STATE	TOTAL SHARE WITHOUT ACCESS	WHITE	AFRICAN AMERICAN	LATINO	ASIAN	NATIVE AMERICAN	SHARE OF STATE'S COLLEGE STUDENTS AT COMMUNITY COLLEGES
Oregon	0.0%	--	--	--	--	--	56.6%
Pennsylvania	0.0%	--	--	--	--	--	26.2%
Rhode Island	0.0%	--	--	--	--	--	26.4%
South Carolina	0.7%	0.3%	1.5%	--	--	--	47.7%
South Dakota	5.0%	1.4%	--	--	--	47.3%	12.2%
Tennessee	41.4%	37.1%	58.9%	--	--	--	37.3%
Texas	6.0%	2.7%	1.4%	13.3%	--	--	59.3%
Utah	25.7%	27.2%	--	24.5%	--	--	21.5%
Vermont	0.0%	--	--	--	--	--	22.7%
Virginia	12.3%	15.3%	12.0%	3.3%	1.7%	--	43.1%
Washington	5.1%	4.7%	7.9%	3.5%	5.8%	--	64.4%
West Virginia	2.3%	2.4%	3.9%	--	--	--	15.8%
Wisconsin	0.4%	0.1%	0.0%	--	--	--	44.0%
Wyoming	0.0%	--	--	--	--	--	72.0%
United States	**8.5%**	**7.5%**	**12.4%**	**10.5%**	**4.5%**	**20.1%**	**45.9%**

Notes: Excludes share of students (denoted by dashes) in a racial/ethnic group when that racial/ethnic group comprises less than 5% of state community college enrollment, and in states where all community colleges participate.

Figures for 'Total Share without Access' include all race/ethnicity categories listed as well as Other/Unknown. See Methodology on page 21.

These figures reflect the definition of community colleges used in this report, which includes both public two-year colleges and public four-year colleges that award primarily associate's degrees and certificates.

TABLE 5: SHARE OF COMMUNITY COLLEGE STUDENTS WITHOUT ACCESS TO FEDERAL LOANS IN 2013-14, BY URBANICITY				
STATE	STATEWIDE	AT URBAN SCHOOLS	AT NON-URBAN SCHOOLS	SHARE OF ALL COMMUNITY COLLEGE STUDENTS AT NON-URBAN SCHOOLS
Alabama	42.7%	64.8%	22.9%	52.7%
Alaska	19.8%	--	19.8%	100.0%
Arizona	5.5%	0.0%	13.6%	40.5%
Arkansas	12.7%	9.1%	14.9%	61.6%
California	12.6%	10.1%	27.9%	14.3%
Colorado	0.0%	0.0%	0.0%	14.3%
Connecticut	3.6%	0.0%	57.0%	6.2%
Delaware	0.0%	0.0%	0.0%	29.7%
Florida	6.6%	5.3%	34.3%	4.4%
Georgia	26.5%	27.3%	24.9%	33.5%
Hawaii	0.0%	0.0%	0.0%	35.3%
Idaho	0.0%	0.0%	0.0%	57.5%
Illinois	6.5%	3.6%	10.9%	39.6%
Indiana	0.0%	0.0%	0.0%	12.0%
Iowa	0.0%	0.0%	0.0%	77.9%
Kansas	0.0%	0.0%	0.0%	69.5%
Kentucky	0.0%	0.0%	0.0%	50.9%
Louisiana	44.1%	40.2%	50.5%	37.7%
Maine	0.0%	0.0%	0.0%	47.2%
Maryland	6.7%	5.6%	12.5%	15.2%
Massachusetts	2.7%	3.4%	0.0%	22.0%
Michigan	0.3%	0.0%	1.4%	19.6%
Minnesota	0.0%	0.0%	0.0%	36.3%
Mississippi	9.5%	--	9.5%	100.0%
Missouri	0.0%	0.0%	0.0%	33.4%
Montana	21.9%	0.0%	26.9%	81.3%
Nebraska	0.3%	0.0%	0.7%	42.2%
Nevada	0.0%	0.0%	0.0%	7.5%
New Hampshire	0.0%	0.0%	0.0%	64.1%
New Jersey	6.4%	8.7%	0.0%	25.7%
New Mexico	3.2%	1.3%	4.7%	54.9%
New York	0.0%	0.0%	0.0%	19.8%
North Carolina	36.0%	14.8%	46.8%	66.4%
North Dakota	4.4%	0.0%	6.9%	64.6%
Ohio	0.0%	0.0%	0.0%	28.2%
Oklahoma	8.6%	7.4%	10.7%	37.7%

TABLE 5: SHARE OF COMMUNITY COLLEGE STUDENTS WITHOUT ACCESS TO FEDERAL LOANS IN 2013-14, BY URBANICITY				
STATE	STATEWIDE	AT URBAN SCHOOLS	AT NON-URBAN SCHOOLS	SHARE OF ALL COMMUNITY COLLEGE STUDENTS AT NON-URBAN SCHOOLS
Oregon	0.0%	0.0%	0.0%	44.2%
Pennsylvania	0.0%	0.0%	0.0%	7.9%
Rhode Island	0.0%	0.0%	--	0.0%
South Carolina	0.7%	0.0%	2.1%	33.2%
South Dakota	5.0%	--	5.0%	100.0%
Tennessee	41.4%	55.7%	27.4%	50.6%
Texas	6.0%	6.1%	5.7%	24.7%
Utah	25.7%	22.3%	46.3%	13.8%
Vermont	0.0%	--	0.0%	100.0%
Virginia	12.3%	0.0%	44.6%	27.7%
Washington	5.1%	3.2%	21.4%	10.3%
West Virginia	2.3%	4.1%	0.0%	43.4%
Wisconsin	0.4%	0.0%	2.5%	13.9%
Wyoming	0.0%	0.0%	0.0%	83.8%
United States	**8.5%**	**6.4%**	**13.9%**	**27.9%**

Notes: For purposes of this analysis, we classify all categories of city and suburb as urban areas and all categories of town and rural as non-urban areas. Dashes indicate that no schools are located in the specific locale.

These figures reflect the definition of community colleges used in this report, which includes both public two-year colleges and public four-year colleges that award primarily associate's degrees and certificates.

RECOMMENDATIONS

All students should have access to federal loans. By offering federal loans – along with the guidance necessary to help students borrow responsibly – colleges provide students with their best chance of staying enrolled and graduating without burdensome debt.

Colleges have the ability to keep defaults low and the vast majority have kept rates below threshold levels. Default sanctions are not an imminent threat for the vast majority of community colleges, and denying access to federal loans does not protect students from debt or the risks that come with it. It merely keeps them from using the type of debt that is likely to be the most manageable, and from getting the guidance and required loan counseling that come with federal student loans and can serve to lower defaults.

The U.S. Department of Education (the Department) took a much-needed step earlier this year by proactively informing colleges about their options for appealing cohort default rate (CDR) sanctions, and highlighting the Participation Rate Index (PRI) in particular.[17] However, both colleges and the Department could and should do more to improve community college students' access to federal student loans and lower CDR defaults.

Federal Recommendations

- The Department should publish colleges' borrowing rates alongside colleges' CDRs to help college administrators, journalists, and the public put CDRs in their proper context. A CDR says more about a college where 90 percent of students borrow than it does about a college where five percent of students borrow, but, without borrowing rates as context, interested parties cannot tell the difference. Additionally, the Department should publish information about federal student loan participation by institution on a regular basis, at least every three years.
- The Department should help address colleges' concerns about CDR sanctions by allowing colleges to certify that their borrowing rates are sufficiently low to allow for a Participation Rate Index appeal. When draft CDRs are sent to colleges along with instructions about how to contest or appeal, colleges could choose to submit the information needed to calculate the school's official participation rate. If a college submits the required data and is found to have a low participation rate, the Department could flag the school's CDR with an asterisk signifying that the rate is based on a small proportion of students. This would likely increase colleges' comfort with and understanding of their CDR and also serve as an opportunity to educate college leaders and administrators about the protections colleges have against unwarranted sanctions.
- The Department should allow colleges to appeal sanctions in any year where their CDR exceeds allowable thresholds, and not make colleges wait until they have exceeded sanction thresholds for three consecutive years before it reviews Participation Rate Index appeals. When a college is first notified that its CDR is above sanction levels, it should be able to submit information to the Department and receive a timely response, which explains whether the college will be able to successfully appeal potential sanctions.
- The Department should continue to provide guidance and outreach to financial aid officers and community college administrators. This should include encouraging colleges to offer federal loans as a way to help their students avoid relying on other forms of consumer debt, providing information about how colleges can counsel potential borrowers and reduce defaults, and clarifying rules for CDR appeals.
- The Department should analyze the potential effects of prorating federal student loans by attendance status. Unlike Pell Grants, federal loans are not prorated based on a student's attendance status. Students who take out full loans but make only part-time progress may be at an increased risk of dropping out and defaulting. Prorating loans would involve reducing student eligibility for federal loans at a time when college is getting harder to afford, but it is possible that it could help encourage students to enroll in more courses per term, thereby completing a degree and reducing their risk of default. It would also address the concerns of some community colleges that part-time student borrowing can outpace their academic progress. Given both the risks and the potential benefits, such a change warrants careful analysis and consideration.
- The Department should enforce federal law on preferred lender lists, which require the inclusion of multiple private lenders, the basis on which colleges chose those specific lenders, and students' right to choose lenders not on the list. Enforcement would serve to call attention to these lists, prompting colleges to improve them or take them down, as the college cited on page 15 did. Community college students who choose to borrow private loans deserve the consumer protections these rules provide, but they cannot benefit if the rules are not enforced.

[17] The U.S. Department of Education. 2014. [illegible] Accessed [illegible] 2014.

Community College Recommendations

- All community colleges should offer federal student loans. Responsible default management plans and entrance and exit counseling, combined with flexible repayment options and loan forgiveness programs, make federal loans relatively safe for both schools and students.
- Community colleges should counsel students when certifying private loans, including notifying them if they could first borrow more in federal loans.

Other Recommendations

- Financial aid and college associations, as well as the Department, should do more to raise awareness and promote a more thorough understanding of the likelihood of default rate sanctions and the ways to mitigate them. Information and trainings should cover not just the Participation Rate Index and other appeals but also effective and low-cost strategies for reducing student defaults.
- Community college districts and system offices should explore whether there are other ways that they can encourage and facilitate loan program participation. For instance, there may be aspects of loan program administration, such as default management, that a system office could do more efficiently than individual colleges with few borrowers.

METHODOLOGY

The U.S. Department of Education (the Department) does not currently maintain a list of institutions that offer Title IV college financial aid but do not participate in the federal Stafford loan program. To identify the 237 non-participating colleges in 2013-14, we looked at data on federal Stafford loans made to students, by college, for the first quarter of the 2013-14 academic year available from the Federal Student Aid Data Center.[50] We used the Integrated Postsecondary Education Data System (IPEDS) institutional classifications for 2011-12 to identify the 1,134 institutions we have defined as community colleges.[51] For the purposes of this analysis, we included both those classified as "public two-year" and also, in acknowledgement of the increasing prevalence of community colleges offering limited bachelor's degree programs, those classified as "public four-year" colleges at which the vast majority of awards granted by the institution are at or below the associate degree level. We excluded schools that were classified in IPEDS as not active, not primarily postsecondary, not Title IV participating, and not open to the public.

Colleges that had distributed any Stafford loans in the first quarter of 2013-14, as reported by the Department, were classified as participating. Those with no Stafford loan distribution were preliminarily classified as "non-participating," and the participation status of each of these colleges was confirmed by checking the college's website or calling the financial aid office.

To assess the level of students' access to federal loans, we used colleges' 12-month enrollment for 2011-12, the most recent available data as reported by the colleges to IPEDS.

All other data cited in this report are the most recent available for the given source.

For purposes of analyzing access to loans by race/ethnicity in this brief we included the following racial/ethnic categories: African American, Asian (includes Pacific Islander), Latino, Native American, Other/Unknown and White. International and multiracial students, and students for whom race/ethnicity is unknown, were classified as Other/Unknown. We did not list state-by-state loan participation rates for racial/ethnic groups that constituted less than five percent of the state's community college enrollment or for the Other/Unknown category.

A list of all non-participating colleges can be found at http://projectonstudentdebt.org/files/pub/CC_participation_status_2013-14.pdf.

[50] U.S. Department of Education, Federal Student Aid Data Center, Title IV Program Volume Reports, [illegible]

[51] U.S. Department of Education, National Center for Education Statistics, Integrated Postsecondary Education Data System (IPEDS) Data Center, [illegible]

APPENDIX: PARTICIPATION RATE INDEX (PRI) WORKSHEET

This worksheet was created by TICAS to help colleges understand their risk of CDR sanctions, available at: *http://www.projectonstudentdebt.org/files/pub//TICAS_PRI_Worksheet_2014.xlsx*

COLLEGE PARTICIPATION RATE INDEX WORKSHEET FOR FY 2011 3-YEAR CDRS	
This worksheet is intended to help colleges understand whether or not their 3-year cohort default rate (CDR) puts them at risk of sanctions. Generally, colleges with 3-year CDRs of 30% or greater for three consecutive years, or greater than 40% for one year, may face federal sanctions. *However*, colleges where fewer than 21% of students borrow federal loans may be able to challenge or appeal sanctions through the Participation Rate Index Challenge or Appeal (a *challenge* is based on a draft CDR and an *appeal* is based on an official CDR). As stated in federal regulation (34 CFR 668.214(d)(1)), "You do not lose eligibility under §668.206 and we do not place you on provisional certification, if we determine that you meet the requirements for a participation rate index appeal." **Important note about student loan defaults**: Defaulting on federal student loans has serious consequences for the borrower. Whether or not your college is at risk of sanctions, it is important for colleges to help their borrowers avoid default. *To complete the worksheet, please enter the requested numbers in the beige cells. Your results will appear in the orange cells.*	
PART I: Your College's Cohort Default Rate (CDR)	
What is your college's FY 2011 3-year CDR?	32.6%
Is this CDR below sanction thresholds?	Your college's CDR is above sanction thresholds. However, your college may be able to challenge or appeal using its Participation Rate Index. Please proceed to Part II.
PART II: Calculate Your College's Participation Rate and Participation Rate Index (PRI)	
How many students at your college borrowed federal loans during any 12-month period between April 2, 2009 - September 30, 2010? Note: Leaving this box blank will be treated as if the college had zero borrowers.	2,028
How many regular students were enrolled at your college on at least a half-time basis during any part (at least one day) of the same 12-month period between April 2, 2009 and September 30, 2010?	12,864
Your college's participation rate:	15.8%
Your college's Participation Rate Index (PRI): Note: Colleges with PRIs at or below 0.0625 can challenge or appeal sanctions based on three consecutive CDRs at or above 30%. Colleges with PRIs at or below 0.0832 can challenge or appeal sanctions based on a single CDR above 40%.	0.0514
Part III: Results, Based on the Data You Have Provided Above	
Your college's estimated eligibility for PRI challenges or appeals:	Your college can use the PRI Challenge or Appeal to avoid sanctions based on three consecutive CDRs at or above 30%.
Your participation rate in context. Based on your college's participation rate this year, your college would be eligible to use the PRI Challenge or Appeal to **avoid sanctions based on three consecutive CDRs** if its CDR were up to the following rate:	39.6%
Your participation rate in context. Based on your college's participation rate this year, your college would be eligible to use the PRI Challenge or Appeal to **avoid sanctions based on a single CDR** if its CDR were up to the following rate:	52.8%

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The views expressed in this report are those of the Institute for College Access & Success (TICAS) and do not necessarily reflect the views of its funders or any individuals or organizations referenced in this report.

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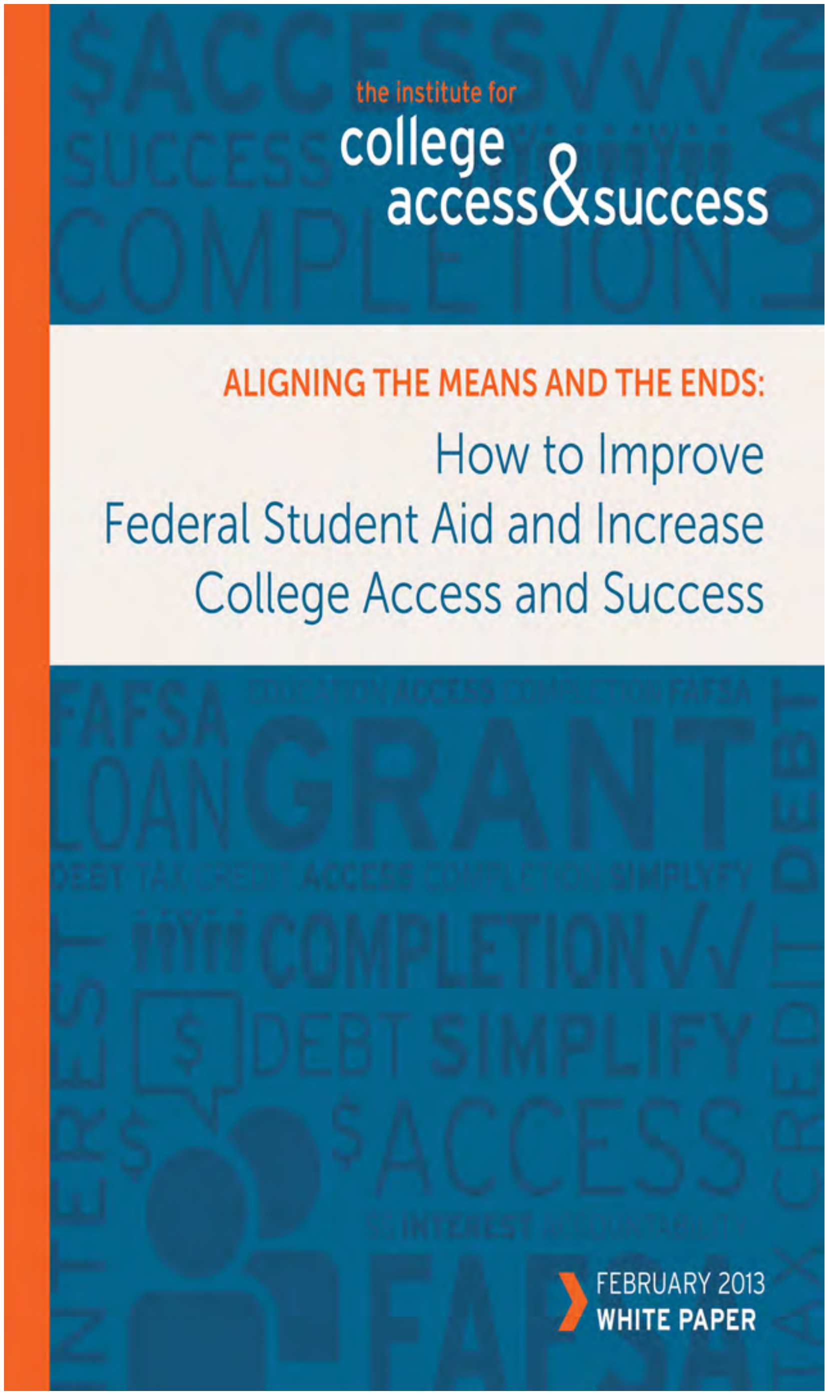
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ALIGNING THE MEANS AND THE ENDS:

How to Improve Federal Student Aid and Increase College Access and Success

FEBRUARY 2013
WHITE PAPER

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Executive Summary

The need for higher education and training has never been so important to individuals and our economy as it is today. Yet, its affordability is seriously in question. College costs have skyrocketed as family incomes and state funding for public higher education have declined, leading millions to take on student debt, drop out, or struggle to keep up with classes while working too many hours to pay the bills. Even after recent significant increases, the maximum Pell Grant today covers the smallest share of the cost of attending a public college since the start of the program 40 years ago. It should be no surprise that the gaps in college enrollment, persistence, and graduation between children from high- and low-income families have widened over the last 30 years, threatening both the American Dream and our nation's economic competitiveness.

Although these gaps cannot be closed with financial aid policy alone, research shows that it can increase enrollment, persistence, and completion. Families would have had a much harder time paying for college over the last five years without the significant increases in Pell Grants, tax benefits, and G.I. Bill benefits. However, even with these increased investments, current federal financial aid policies have not closed the growing gaps in access and success. Based on the available research, there are at least five major reasons why:

- Available need-based grant aid is insufficient to overcome gaps in access and success.
- Students and families lack sufficient information about costs, financial aid, and outcomes to make fully informed decisions about which colleges to apply to and attend.
- The complexity of the current federal aid application process and programs undermines their effectiveness.
- States and colleges are not held sufficiently accountable for ensuring that their students receive a quality education and can complete without burdensome debt.
- Changes to financial aid programs have not consistently prioritized access and success for financially needy students.

This white paper includes recommendations to address each of these problems by reforming federal grant, loan, and tax policies, increasing accountability, and providing students and families with the information they need to make wise decisions about where to go to college. Some of these changes require additional investments, and this paper includes options that would more than pay for the recommended reforms. Many of those options enjoy bipartisan support and have been endorsed by a broad range of organizations and experts, underscoring that the question is whether our nation has the will to make the needed changes.

Student Eligibility and Accountability: Simplify the aid application process while better targeting aid and preventing fraud.

There is widespread agreement that the current federal student aid application process is so complex in structure and timing that it can be an obstacle rather than a path to a college education. While significant progress has been made in recent years, the Free Application for Federal Student Aid (FAFSA) still rivals the full 1040 tax form in length. Students still do not learn how much aid they are eligible for until after they have already applied to colleges, and the lowest income students do not benefit from recent simplification measures. Research shows that both the timing and process can be greatly improved while still targeting aid to needy students.

- Calculate aid eligibility using the tax or W-2 data available when students typically apply to college. This one change would dramatically simplify the process for both students and schools, and tell students how much aid they can expect before, rather than after, they apply to colleges.

- Streamline the verification process that occurs after students submit the FAFSA to ensure eligible students get aid and reduce burdensome paperwork for schools and students.

- Improve the federal needs analysis formula to better target aid while reducing the number of questions that cannot be answered by existing tax and wage data.

- Better prevent fraud by having the U.S. Department of Education (the Department) flag aid applicants with histories that suggest fraud. In these cases, colleges should determine aid eligibility based on the applicant's total enrollment history, including at prior schools, so they cannot enroll and withdraw at school after school while receiving federal aid.

College Eligibility and Accountability: More closely tie a college's eligibility for funding to the risk students take by enrolling and the risk taxpayers take by subsidizing it, and reward schools that serve students well.

While students are, and should, be held accountable for studying and making progress toward a credential, there are few consequences for schools that fail to graduate large shares of students or consistently leave students with debts they cannot repay. Taxpayer dollars should not subsidize schools that routinely do more harm than good. The data are clear that some schools do much better than their peers at enrolling and graduating similar students without burdensome debt. To ensure that available federal aid dollars are spent wisely, we recommend more closely tying colleges' eligibility to the risks they pose to students and taxpayers. This means rewarding colleges that serve low-income students well with more funds and greater flexibility to innovate, while strengthening oversight and accountability measures to prevent waste, fraud, and abuse.

- Sanction schools based on their Student Default Risk Index (SDRI) rather than their Cohort Default Rate (CDR). The CDR reflects only the share of a school's student loan borrowers who default. The SDRI is the three-year CDR multiplied by the school's borrowing rate. By incorporating the share of students who borrow loans into the measure, the SDRI more accurately conveys a student's risk of defaulting at a given school.

- Require risk-sharing by schools if they receive a majority of their revenue from federal student aid and have SDRIs that are relatively high but fall below the eligibility cutoff. Currently, a school's eligibility for federal aid is all or nothing, with no risk-sharing in place, regardless of how much taxpayer funding it receives.

- Reward colleges with very low SDRIs with additional flexible funding based on their low-income student enrollment. By basing the additional funding on Pell Grant dollars disbursed, colleges would be encouraged to enroll low-income students and help them apply for aid and enroll full time.

- Let colleges with strong track records have more flexibility to innovate. With few exceptions, federal policies currently treat all colleges alike, regardless of their record of serving students well. This one-size-fits-all approach to regulation and oversight tends to over-regulate the best colleges and underregulate the worst.

- Improve oversight and other accountability measures to better protect students. Whether schools are sanctioned using the current CDR standards or a more robust SDRI, additional policy changes must be made to ensure the integrity of the federal student aid programs.

Grant Aid: Secure and improve Pell Grants.

Research shows that need-based grant aid increases college enrollment among low- and moderate-income students and reduces their likelihood of dropping out of college. In particular, studies have found that Pell Grant recipients are more likely than other low-income students to stay enrolled and succeed. Research also suggests that the current complexity of the Pell Grant program and the fact that students do not know how much aid they will receive until after they have applied to colleges reduces Pell's effectiveness. However, even the best designed program will not be effective if it is not adequately funded. To close the widening income gaps in college access and success, we need to both improve the Pell Grant program in ways that do not cost money and dramatically increase our investment, while requiring that states and colleges also do their share.

- Double the maximum Pell Grant to close income gaps in access and attainment. Based on existing research, the maximum Pell Grant needs to be dramatically increased to overcome the current income gaps in enrollment and completion. Even a doubled maximum grant of $11,270 would cover a smaller share of the cost of attending a public college than it did in the late 1970s.

- Make Pell Grants a mandatory program. As long as Pell Grant funding is subject to annual appropriations based on projections that can turn out to be too high or too low, its cost and funding will never be perfectly aligned. This puts the program in jeopardy, creating unnecessary uncertainty for students and schools and putting college access and success at risk.

- Rename Pell Grants as Pell Scholarships to better convey the academic expectations of all recipients.

- Limit Pell eligibility while enrolled less than half time to two terms, to encourage timely completion while recognizing the challenges facing low-income students.

- Limit Pell eligibility to 7.5 years, excluding up to one year of remedial coursework, to allow completion of a bachelor's degree while meeting requirements for satisfactory academic progress. Current federal aid policies permit students to take up to 7.5 years to complete their bachelor's degree, but low-income students may only receive Pell Grants for up to six years.

- Congress should consider maintenance of effort provisions to ensure that new federal dollars supplement – rather than supplant – state and other forms of higher education funding and financial aid.

Student Loans: Reduce complexity, improve targeting, contain debt burdens, and encourage completion and wise borrowing.

The current federal student loan program is too complex, its terms are too arbitrary, and its benefits are poorly targeted. Much of the complexity is a holdover from when banks received subsidies to make Stafford Loans that were guaranteed by the government, shielding lenders – but not borrowers or taxpayers – from risk. Now that these loans are made directly and more cost-effectively by the Department of Education, the entire student loan system can and should be streamlined and improved. Subsidized Stafford Loans currently provide students with particularly valuable benefits, including a low fixed interest rate and no interest accrual while the student is in school. However, these benefits are not well targeted, as high-income students may qualify just because they attend a high-cost college. In addition, eight in 10 students with subsidized loans also have unsubsidized loans, diluting the subsidy's benefits. In July, the subsidized loan's interest rate is scheduled to double from 3.4 percent to 6.8 percent, while interest rates on 10-year Treasury notes are currently two percent. Reform is clearly and urgently needed. Our loan recommendations aim to better support access and success while containing costs and risks for both students and taxpayers.

- Provide a single undergraduate student loan with a fixed interest rate and no fees, in place of the two types of Stafford Loans available today. To support and encourage students to stay enrolled and complete, the loan would have a low interest rate while the student is in school, based on the government's cost of borrowing. When the loan enters repayment, the interest rate would rise by a set margin, but the total rate could never exceed a designated cap.
    - To help borrowers who go to school when interest rates are unusually high, the loan would have a built-in form of insurance that would keep their rates from ever being too much higher than the rate on loans being offered to current students.

  - To provide a targeted safety net for borrowers from low-income families, Pell Grant recipients would be eligible for interest-free deferments during periods of unemployment and economic hardship.

- Streamline and improve federal loan repayment options by:

  - Offering one income-based repayment plan that lets any borrower choose the assurance of manageable payments and forgiveness after 20 years. Right now there are three such plans with different eligibility criteria and payment formulae, with one more set to launch in 2014. Our proposal simplifies and improves this important repayment option.

  - Enabling borrowers to make one payment that covers all their federal loans, and basing standard repayment periods on the borrower's total federal student loan debt. These changes reduce unnecessary complexity and obstacles to continuous, on-time payments.

- Improve the timing, content, and effectiveness of student loan counseling to help students borrow wisely, complete college without burdensome debt, pick a repayment plan that works for them, and repay their loans.

- Prevent student loan defaults by automatically enrolling severely delinquent borrowers in an income-based repayment plan; targeting outreach to borrowers showing signs of financial distress; and providing discharges when students are defrauded by their college, to be paid for by the school.

- Reduce financial distress by reconsidering the use of private debt collectors for defaulted federal loans; protecting income for basic necessities when collecting on defaulted loans; and ensuring there is a way out of default for all borrowers willing to take responsibility.

- Strengthen consumer protections for private loan borrowers by requiring school certification for all private education loans; enabling private loan borrowers to refinance or modify their loans; and treating private loans like credit cards and other similar types of debt in bankruptcy.

Tax Expenditures: Streamline and improve the targeting of higher education tax benefits.

Current higher education tax provisions are too poorly timed and poorly targeted to efficiently increase college access or success. We therefore recommend eliminating them and redirecting the savings (more than $100 billion over the first five years alone) into Pell Grants and incentive funds for states and colleges to increase college access, affordability, and success. Nevertheless, there is strong bipartisan support for higher education tax benefits. The American Taxpayer Relief Act of 2012 included more than $90 billion in such benefits that would have otherwise expired, including the extension of two of the most regressive and poorly targeted benefits: the student loan interest deduction and the tuition and fees deduction. If Congress is unwilling to eliminate current tax expenditures and redirect the savings to Pell Grants and other programs that more effectively and efficiently support college access and success, then we recommend dramatically streamlining and improving the targeting of higher education tax benefits. Our other tax recommendations call for simpler and more equitable tax treatment of Pell Grants and forgiven loans.

- If higher education tax benefits are to be retained, we recommend:
    - Streamlining the benefits by creating an improved American Opportunity Tax Credit (AOTC). Research suggests the AOTC is the most likely of the current tax benefits to increase college access and success. We recommend improving its likely efficiency and effectiveness by enhancing its benefits for low- and moderate-income students and for students attending community colleges. These changes would be paid for by eliminating other less targeted, less effective tax benefits, including the tuition and fees deduction, student loan interest deduction, Lifetime Learning Credit, and exclusion of earnings from Coverdell education savings accounts.
    - Better aligning eligibility for higher education tax benefits with student aid administered by the Department.
- Stop taxing forgiven or discharged student loans as income. Regardless of the reason for the discharge, no discharged or forgiven student loan debt should be treated as taxable income. This will correct current inequities that, for instance, exempt discharges resulting from school closures from taxation while taxing discharges for totally and permanently disabled borrowers.
- Stop taxing Pell Grants as income. To increase fairness, simplify the tax code, and improve coordination with the AOTC, Pell Grants should not be treated as taxable income if they are used for a qualified education expense.

Better Information: Provide students with key information when they need it.

We can increase the impact of financial aid by providing students and families with key information when they need it to make decisions about whether to go to college, where to go, and how to pay for it. However, much of the information students and families need is not currently available, or not available in a way that students can easily find and use. College is too important, and families and taxpayers pay too much for it, for us to lack basic information about costs, aid, and outcomes.

- Provide key data on cumulative student debt, private loan borrowing, loan defaults, and graduation rates. Before they decide where to apply and go to college, students need to know their chances of graduating and their chances of graduating with debt, particularly high debt and/or risky private loan debt. It is crucial that such data be collected and made available to both consumers and policymakers given rising debt and default levels.
- Provide proactive estimates of federal aid eligibility so students know they can afford college, and improve the free, online FAFSA4caster so it is easier to compare likely aid to costs at specific colleges. For students and families ready to select schools, create and

promote College Scorecards with key information on every college, and make net price calculators easier to find, use, and compare.

- Require all colleges to use a standard format for financial aid award letters that makes it easy for families and students to understand and compare what they would need to save, earn or borrow at each college to which they have been admitted.
- Conduct consumer testing to ensure that information is presented in the most effective way, including for audiences with little or no college knowledge or experience.

Introduction

The American Dream envisions a nation where everyone can fully participate in our democracy, and our fates are determined by ability and accomplishment rather than circumstances of birth. Ensuring college access and increasing student success are crucial to achieving and preserving that dream and the economic opportunity and mobility on which it depends. College education is increasingly the primary path to stable employment, higher wages, retirement benefits, and health insurance, as well as a key predictor of civic participation, better health, and the next generation's odds of getting ahead – or at least not falling behind. An educated workforce is also essential to America's economic competitiveness: our nation needs more people to get quality training and education after high school than ever before. However, as college education has become more essential for all these reasons, income gaps in enrollment and completion have widened rather than narrowed.

To meet the broadly shared goal of greatly increasing the share of Americans with a college education, federal student aid policies must be improved to expand access and better support success for lower income students. When student financial aid works as it should, students who are willing to study hard can afford to go to college, which is what we mean by college access; and they can complete a meaningful degree or certificate without burdensome debt, which is what we mean by student success.

For this white paper, we analyzed the latest data on the cost and distribution of major federal grants, loans, and tax benefits intended to help students and their families pay for college. We reviewed the most current and robust research and analyses to assess how well these sources of aid support student access and success and the key obstacles to increasing low-income students' completion of quality credentials. Based on this analysis, we developed evidence-based guiding principles and used them to identify reforms likely to have a substantial positive effect on college access and success. Below is a description of our main findings and principles, followed by specific policy recommendations in six major areas: Student Eligibility and Accountability; College Eligibility and Accountability; Grant Aid; Student Loans; Tax Expenditures; and Better Information. An appendix provides options to pay for the reforms we propose.

Section 1: Context, Evidence, and Principles for Reform

College is increasingly important for economic growth and opportunity, but more families are struggling to pay for college.

The many benefits of higher education have been well documented over time. According to the Georgetown Center on Education and the Workforce, holding a bachelor's degree is associated with a median lifetime income of $2.8 million, 84 percent higher than a worker with a high school diploma.[1] Additionally, the unemployment rate for workers with a degree is significantly lower than for those without: in 2012, 4.5 percent for workers with a B.A. compared to 8.3 percent for those with a high school diploma.[2] These differences are even starker for young adults aged 25 to 34: those with only a high school diploma are more than three times as likely to be unemployed as those with a bachelor's degree.[3] A recent report released by The Pew Charitable Trusts showed how these benefits helped college graduates weather the recent economic upheaval. Although all groups of workers were hit by the recession, recent college graduates suffered significantly smaller increases in unemployment and smaller declines in wages than their non-degreed peers.[4] In addition to the wage premium and higher rates of employment, college graduates are more likely to have health and retirement benefits. Even after controlling for personal characteristics, on average college graduates are also more satisfied with their jobs, healthier, and more involved citizens and parents.[5]

The public is also well aware of the value of a college education. Recent surveys consistently find nearly universal recognition of its importance for individuals and the economy, widespread concerns about costs and debt, and broad support for making college affordability and financial aid policy priorities.[6]

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[1] Georgetown University Center on Education and the Workforce. 2011. *The College Payoff: Education, Occupations, Lifetime Earnings.* http://www9.georgetown.edu/grad/gppi/hpi/cew/pdfs/collegepayoff-complete.pdf.

[2] U.S. Department of Labor, Bureau of Labor Statistics. 2012. Employment Projections. "Education Pays." http://www.bls.gov/emp/ep_chart_001.htm.

[3] Calculations by TICAS on data from the U.S. Census Bureau, Current Population Survey, 2012 Annual Social and Economic Supplement, Table PINC-04; and unpublished data from the Bureau of Labor Statistics, Current Population Survey, 2011 annual average for unemployment rates. Young adults are defined as persons aged 25 to 34.

[4] The Pew Charitable Trusts Economic Mobility Project. 2013. *How Much Protection Does a College Degree Afford: The Impact of the Recession on Recent College Graduates.* www.pewstates.org/uploadedFiles/PCS_Assets/2013/Pew_college_grads_recession_report.pdf.

[5] The College Board. 2010. *Education Pays 2010: The Benefits of Higher Education for Individuals and Society.* http://trends.collegeboard.org/education-pays.

[6] Hart Research Associates, commissioned by HCM Strategists. 2013. *College Is Worth It: A Report On Beliefs About The Importance Of College, Impressions Of The Financial Aid System, Priorities For Reform, And Reactions To Potential Reform Approaches.* http://hcmstrategists.com/americandream2-0/report/FINALHartPublicOpinionResearch.pdf. Lake Research Partners and Bellwether Research and Consulting, commissioned by TICAS, Dēmos, and Young Invincibles. 2011.

Despite strong public support for higher education, and its clear monetary and nonmonetary value, the demand for college-educated workers is projected to increase at double the rate of the supply.[7] State funding for public colleges has declined by almost one-fourth since 2002, while tuition and fees at four-year public institutions have increased by 5.2 percent annually over the same period *after* adjusting for inflation (2.4% for private nonprofit four-year colleges and 3.9% for public two-year schools).[8] Students also have to cover other costs such as books, food, and housing, which are considered part of the full cost of attendance and have increased as well. Meanwhile, the average family income is less today than it was a decade ago.[9] To illustrate the growth in college prices compared to other changes in the economy, compare two students working full time over the summer to cover college costs. In 1980, at the average public four-year school, a student who worked full time over the summer at a minimum wage job could cover tuition the next year and have the 2012 equivalent of $1,923 left over.[10] In 2012, a student who worked full time over the summer at a minimum wage job would cover only 42 percent of tuition at an average public four-year school, leaving them $4,764 short. The United States will not be able to meet the economy's demand for college-educated workers without addressing college affordability.

With college costs and family incomes going in opposite directions, it is no surprise that students from lower income families have struggled to pay for college. Even after taking into account grant aid, the lowest income families would have to contribute almost three-quarters (72%) of their annual household income each year to cover the net price of sending one child to a four-year college, whereas middle- and high-income families would have to contribute amounts equivalent to 27 percent and 14 percent of their yearly earnings, respectively.[11]

This outsized impact of increased costs on lower income students is a major factor in the widening gap in college access and success by income.[12] In 2010, the gap in immediate college enrollment between high school completers from low-income families and those from high-income families was 30 percentage points (52% and 82%, respectively), and new research in 2011

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http://ticas.org/pub_view.php?idx=793. Hart Research Associates, commissioned by the College Board. 2011. *One Year Out: Findings From A National Survey Among Members Of The High School Graduating Class Of 2010.* http://media.collegeboard.com/homeOrg/content/pdf/One_Year_Out_key_findings%20report_final.pdf. Public Agenda. 2011. *Slip-Sliding Away: An Anxious Public Talks About Today's Economy and the American Dream.* http://www.publicagenda.org/pages/index.php?qid=245. Pew Research Center. 2011. *Is College Worth It?*

College Presidents, Public Assess, Value, Quality and Mission of Higher Education. http://www.pewsocialtrends.org/2011/05/15/is-college-worth-it/.

[7] Georgetown University Center on Education and the Workforce. 2011. *The Undereducated American.* http://cew.georgetown.edu/undereducated

[8] The College Board. 2012. *Trends in College Pricing 2012.* http://trends.collegeboard.org/college-pricing. Figures 4 and 12a.

[9] Ibid. Figure 18a.

[10] Young Invincibles. 2012. *Student Perspective on Federal Financial Aid Reform.* http://younginvincibles.org/wp-content/uploads/2012/11/Final-White-Paper-All-Edits.pdf.

[11] The Education Trust. 2011. *Priced Out: How the Wrong Financial-Aid Policies Hurt Low-Income Students.* http://www.edtrust.org/sites/edtrust.org/files/PricedOutFINAL.pdf.

[12] The Advisory Committee on Student Financial Assistance (ACSFA). 2006. *Mortgaging our Future: How Financial Barriers to College Undercut America's Global Competitiveness.* http://www2.ed.gov/about/bdscomm/list/acsfa/mof.pdf

showed that children born to families in the top income quartile are more than twice as likely to enroll in college, and six times as likely to complete a B.A. by age 25, as those in the bottom income quartile.[13]

Both to meet the human capital needs of the economy and to ensure equal opportunity for all Americans, it is imperative that we design public policy to maintain and increase college access and student success.

Although access and completion gaps cannot be closed with financial aid alone, research shows that aid can and does increase enrollment, persistence, and completion.

Many of the causes of income gaps in college access and success lie beyond the reach of financial aid policy. For instance, first-generation students whose parents have limited college knowledge may find it impossible to navigate the process of applying. Students who leave high school ill-equipped for college are less likely to succeed once they are there. Just as financial aid can help to make college more affordable, investments in other supports – including outreach, counseling, and tutoring – are critical to overcome other barriers to access and success to truly close the gaps.

Research has shown that, even among students with similar academic preparation attending similar types of schools, income gaps in college access and completion persist. By reducing the gap between the cost of college and what families can afford to pay, financial aid can help increase enrollment, persistence, and completion. When that gap is not fully closed, the remainder is called "unmet need." Students with more unmet need are less likely to enroll in college than those with less, and enrolled students who have unmet need are less likely to earn degrees than those who do not.[14] Having sufficient resources to cover college costs – from savings, earnings, grant aid, or manageable loans – helps students complete by reducing their need to work and supporting their time studying and in class. In fact, research shows that students working 15 or more hours a week are more likely to drop out of college than those working fewer hours.[15]

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[13] Bailey, Martha J. and Susan M. Dynarski. 2011. *Gains and Gaps: Changing Inequality in U.S. College Entry and Completion.* National Bureau of Economic Research. Working paper 17633. http://www.nber.org/papers/w17633. U.S. Department of Education, National Center for Education Statistics. 2012. *The Condition of Education 2012.* Table A-34-1. http://nces.ed.gov/programs/coe/tables/table-trc-1.asp.

[14] Noel-Levitz. 2007. *Access Alert: How the Neediest Students Can Gain Access and Succeed Through Strategic Financial Aid Awarding.* http://bit.ly/XA0gTq. Titus, Marvin A. 2006. *No College Student Left Behind: The Influence of Financial Aspects of a State's Higher Education Policy on College Completion.* The Review of Higher Education, Vol. 29, No. 3.

[15] CALPIRG. 2009. *Working Too Hard to Make the Grade: How Fewer Work Hours and More Financial Aid Can Help California Community College Students Succeed.* http://www.uspirg.org/sites/pirg/files/reports/workingtoohard.pdf. American Council on Education. 2002. *Crucial Choices: How Students' Financial Decisions Affect Their Academic Success.* http://armasineducation.com/documents/crucialchoices.pdf. Orszag, Jonathan M., Peter R. Orszag, and Diane M. Whitmore, commissioned by UPromise, Inc. 2001. *Learning and Earning: Working in College.* http://www.brockport.edu/career01/upromise.htm.

Although more is needed, a great deal of research has explored the effectiveness of different types of financial aid programs. This paper does not provide an exhaustive review of the literature,[16] but highlights key points from the research that should inform policy decisions about redesigning aid programs.

Grant programs have a positive effect on enrollment, persistence, and completion.

Enrollment

Many researchers have studied the effectiveness of grant programs at the federal, state, and institutional levels. A general consensus has emerged that grant aid increases students' likelihood of enrolling in college: on average, each $1,000 of grant aid a student receives increases his or her likelihood of enrollment by about four percentage points.[17] The positive effect of grant aid on enrollment has been documented in studies of several state grant programs, veterans' benefits, and the Social Security Student Benefit Program, and has been particularly pronounced with programs with easy-to-understand eligibility criteria, simple application processes, and outreach efforts to ensure eligible students know about them.[18]

Notably, the federal Pell Grant program has none of these features, which likely explains why research on the effectiveness of Pell Grants on enrollment has been less conclusive.[19] According to Bridget Terry Long, a professor of education and economics at the Harvard Graduate School

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[16] For a detailed review of the research on the effectiveness of different types of financial aid, see: Castleman, Benjamin and Bridget Terry Long. 2012. *Looking Beyond Enrollment: The Causal Effect of Need-Based Grants on College Access, Persistence and Graduation.* http://bit.ly/Y0FUCW. Scott-Clayton, Judith. 2012. *Information Constraints and Financial Aid Policy.* National Bureau of Economic Research. Working Paper 17811. http://www.nber.org/papers/w17811. Deming, David and Susan Dynarski. 2009. *Into College, Out of Poverty? Policies to Increase the Postsecondary Attainment of the Poor.* National Bureau of Economic Research. Working Paper 15387. http://www.nber.org/papers/w15387.

[17] Long, Bridget Terry. 2008. *What Is Known About the Impact of Financial Aid? Implications for Policy.* National Center for Postsecondary Research. Working Paper. http://www.eric.ed.gov/PDFS/ED501555.pdf. Deming and Dynarski 2009.

[18] Cornwell, Christopher, David B. Mustard, and Deepa J. Sridhar. 2006. *The Enrollment Effects of Merit-Based Financial Aid: Evidence from Georgia's HOPE Program.* Journal of Labor Economics. Vol. 24, No. 4. http://www.terry.uga.edu/hope/hope.enrollments.pdf. Turner, Sarah and John Bound. 2002. *Closing the Gap or Widening the Divide: The Effects of the G.I. Bill and World War II on the Educational Outcomes of Black Americans.* National Bureau of Economic Research. Working Paper 9044. http://www.nber.org/papers/w9044. Dynarski, Susan. 2000. *Hope for Whom? Financial Aid for the Middle Class and Its Impact on College Attendance.* National Bureau of Economic Research. Working Paper 7756. http://www.nber.org/papers/w7756. Dynarski, Susan M.. 1999. *Does Aid Matter? Measuring the Effects of Student Aid on College Attendance and Completion.* National Bureau of Economic Research. Working Paper 7422. http://www.nber.org/papers/w7422. Brackett, Margaret H., Craig S. Gordon, and Gary T. Henry. 1999. *HOPE Longitudinal Study: Year 2 Results.* Applied Research Center of the Andrew Young School of Policy Studies.

http://www.issuelab.org/resource/hope_longitudinal_study_year_2_results. Bound, John and Sarah E. Turner. 1999. *Going to War and Going to College: Did World War II and the G.I. Bill Increase Educational Attainment for Returning Veterans?* National Bureau of Economic Research. Working Paper 7452. http://www.nber.org/papers/w7452. Angrist, Joshua D. 1990. *The Effect of Veterans Benefits on Veterans' Education and Earnings.* National Bureau of Economic Research. Working Paper 3492. http://www.nber.org/papers/w3492.

[19] Some studies have not found an effect on enrollment, while others found an effect for certain populations. See: Seftor, Neil and Sarah Turner. 2002. *Back to School: Federal Student Aid Policy and Adult College Enrollment.* The Journal of Human Resources. Vol. 37, No. 2. http://bit.ly/VOmmu. Heller, Donald E.. 1997. *Student Price Response in Higher Education: An Update to Leslie and Brinkman.* The Journal of Higher Education. Vol. 68, No. 6. Long 2008.

of Education, "[T]he most convincing explanations for the lack of a response among low-income students to the Pell Grant focus on problems with the program itself…. researchers suggest that low program visibility, the complexity of the application process, and intimidating audit procedures contributed to limiting the aid program's impact."[20] Making the Pell Grant program simpler and easier to apply for – much like other need-based grant programs that have been shown to have significant effects – would likely increase its effectiveness.[21] The impact of Pell Grants and other grant aid on enrollment may be further undermined and harder to assess because so many low-income students do not realize how much grant aid they are eligible for until *after* they have applied and been admitted to a college. Too many college financial aid award letters do not clearly distinguish grant aid from loans, further reducing the impact of the grant aid on enrollment decisions.[22]

Persistence and completion

Many studies have also found a positive effect of grant aid, and Pell Grants in particular, on persistence and completion. Though low-income students generally have lower success rates than higher income students, studies have found that Pell Grants can help to close the gap, as recipients are more likely to stay enrolled and succeed than low-income students who do not receive grants.[23] Studies of other need-based grant programs have also found that grants help students persist and succeed,[24] with one study documenting that an increase of $1,000 in grant aid in a Pell recipient's first year was associated with a two- to four-percentage-point increase in enrollment in the second year.[25]

The effectiveness of grant aid may be explained in part by its timing. For families with limited resources, financial aid is most helpful when provided at the time students need to pay for college costs. In fact, a recent survey found that over half (52%) of students who dropped out of college did so because they could not afford the tuition and fees.[26] Another study of emergency financial aid programs at community colleges and tribal colleges found that those programs

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[20] Long 2008. Pp 17.

[21] Deming and Dynarski 2009 and Bowen, William G., Matthew M. Chingos, and Michael S. McPherson. 2009. *Crossing the Finish Line: Completing College at America's Public Universities*. Princeton, NJ: Princeton University Press.

[22] For more information, see *TICAS Comments on Draft Financial Aid Shopping Sheet*: http://ticas.org/files/pub/TICAS_comments_on_financial_aid_shopping_sheet.pdf.

[23] Chen, Rong and Stephen L. DesJardins. 2008. *Exploring the Effects of Financial Aid on the Gap in Student Dropout Risks by Income Level*. Research in Higher Education. Vol. 49, No. 1. Bettinger, Eric. 2004. *How Financial Aid Affects Persistence from College Choices: The Economics of Where to Go, When to Go, and How to Pay for It*. National Bureau of Economic Research. Working Paper 10242. http://www.nber.org/papers/w10242.

[24] Bettinger, Eric. 2010. *Need-Based Aid and Student Outcomes: The Effect of the Ohio College Opportunity Grant*. http://www.sesp.northwestern.edu/docs/need-based-aid-why.pdf. Heller, Donald. 2003. *Informing Public Policy: Financial Aid and Student Persistence*. WICHE. http://www.wiche.edu/info/publications/InformingPublicPolicy.pdf

[25] Goldrick-Rab, Sara, Douglas N. Harris, Robert Kelchen, and James Benson. 2012. *Need-Based Financial Aid and College Persistence: Experimental Evidence from Wisconsin*. http://bit.ly/12iY97R.

[26] Public Agenda. 2009. *With Their Whole Lives Ahead of Them: Myths and Realities about Why So Many Students Fail to Finish College*.

helped students struggling with immediate expenses remain in college.[27] Without access to funds at the time they are needed, low-income students may find their college plans derailed by crucial expenses that need to be paid right away.

Research on other types of aid.

There is less research on the effectiveness of loans or tax credits on student enrollment, persistence, and completion, and the collective findings are less conclusive. However, studies that compare the relative effects of grants, loans, and work-study have found that grants are most effective in increasing the likelihood of enrollment and completion.[28]

Loans

According to recent surveys, student loan debt is a major concern for the general public as well as young adults, lower income parents of color, and engaged voters.[29] At least two-thirds of students who graduated from four-year colleges in 2011 had loans, compared to less than half in 1993.[30] Borrowers in the Class of 2011 owed an average of $26,600.[31] At least 38 million borrowers at all stages of life hold a total of more than $1 trillion in outstanding education loan debt, including federal and private undergraduate, graduate, and parent loans.[32]

Student loans have become a fact of life for more and more Americans as college costs have outpaced both family incomes and available need-based grant aid. This is particularly true for low-income students. Pell Grant recipients – the vast majority of whom have family incomes below $40,000 – are more than twice as likely as other students to have loans.[33] Of those who complete a four-year degree, nine out of 10 Pell recipients have loans, and their average debt at graduation is several thousand dollars more than their higher income peers'.[34] At community colleges, which enroll the majority of low-income and minority students, less than 15 percent of

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[27] MDRC. 2008. *Helping Community College Students Cope with Financial Emergencies Lessons from the Dreamkeepers and Angel Fund Emergency Financial Aid Programs.* http://www.mdrc.org/helping-community-college-students-cope-financial-emergencies.

[28] Li, Dai. 2008. *Degree Attainment of Undergraduate Student Borrowers in Four-Year Institutions: A Multilevel Analysis.* Journal of Student Financial Aid. Vol. 37, No. 3. http://bit.ly/14HbrxP. Moore, Robert L., A.H. Studenmund and Thomas Slobko. 1991. *The Effect of the Financial Aid Package on the Choice of a Selective College.* Economics of Education Review. Vol. 10, No. 4.

[29] For example, see: Hart Research Associates, commissioned by HCM Strategists 2013. Lake Research Partners and Bellwether Research and Consulting, commissioned by TICAS, Demos, and Young Invincibles. 2011.

[30] TICAS. 2010. *Quick Facts about Student Debt.* http://projectonstudentdebt.org/files/File/Debt_Facts_and_Sources.pdf

[31] TICAS. 2012. *Student Debt and the Class of 2011.* http://projectonstudentdebt.org/files/pub/classof2011.pdf.

[32] U.S. Consumer Financial Protection Bureau. July 19, 2012. Press release. "Consumer Financial Protection Bureau and U.S. Department of Education Joint Report Finds a Cycle of Boom and Bust in Private Student Loan Market." http://1.usa.gov/Y3gLUB . U.S. Department of Education. 2011. *FY 2011 Federal Student Aid Annual Report.* http://www2.ed.gov/about/reports/annual/2011report/fsa-report.pdf. P. 2.

[33] TICAS. 2012. *Pell Grants Help Keep College Affordable for Millions of Americans.* http://ticas.org/files/pub//Overall_Pell_one-pager_11-26-12.pdf

[34] TICAS 2010.

students borrow,[35] but more than a third of community college students who complete associate's degrees do.[36] At for-profit colleges, which enroll a disproportionate share of low-income and underrepresented minority students, almost everyone borrows, regardless of whether they graduate.[37]

While they may not feel that way to students and families, federal student loans are a form of financial aid. These taxpayer-backed loans are intended to keep college within reach when savings, earnings, grants, and scholarships fall short of total college costs. They provide access to credit with capped interest rates, flexible repayment plans, and consumer protections that would not otherwise be available to students. Federal student loans also have to be repaid, and default on one has very severe consequences for borrowers as well as potential costs to taxpayers. As rising student debt and default levels capture headlines, students may be getting signals to avoid student loans at all costs. The costs of avoidance, however, can themselves be high. Students may decide that it is not worth it to pursue college or training after high school. They may go to college in ways that greatly reduce their odds of completion, such as delaying enrollment or re-enrollment, going part time, or working long hours while in school. They may also take on much riskier debt than federal student loans by using credit cards, installment plans, payday loans, or private education loans.

Overall, there is mixed evidence connecting loans with enrollment, persistence, and completion. Some studies show some relationship, particularly for subsidized loans, while others have found no relationship or an unclear one.[38] As with Pell Grants (see discussion above), the complexity of federal loans likely undermines researchers' ability to assess their effectiveness. For example, consider federal subsidized student loans, on which the government pays the interest while the student is enrolled. This subsidy is a substantial financial benefit for recipients, one that saves borrowers thousands of dollars over the life of their loans.[39] However, because most recipients of subsidized loans also receive unsubsidized loans, the subsidy's impact may be blunted as well as harder to assess.

In addition, little is known about the long-term repercussions of loans, including the costs and consequences of defaults and the effects of student debt on behaviors such as family formation, homeownership, and saving for retirement. While such effects can be hard to quantify, one survey found for every $5,000 in student loan debt, the likelihood of owning a home decreased by one percent.[40]

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[35] Calculations by TICAS on data from the U.S. Department of Education, 2008 National Postsecondary Student Aid Study (NPSAS).

[36] The College Board. 2009. *How Much are College Students Borrowing?* http://advocacy.collegeboard.org/sites/default/files/09b_552_PolicyBrief_WEB_090730.pdf.

[37] Ibid.

[38] Singell, Larry D. 2004. *Come and stay a while: Does financial aid effect retention conditioned on enrollment at a large public university?* http://digitalcommons.ilr.cornell.edu/cgi/viewcontent.cgi?article=1011&context=cheri. Young Invincibles. 2012. *Student Perspective on Federal Financial Aid Reform.* http://younginvincibles.org/wp-content/uploads/2012/11/Final-White-Paper-All-Edits.pdf. Long 2008.

[39] For more details, see http://views.ticas.org/?p=753.

[40] Long 2008.

Tax Credits

Federal higher education benefits provided through the tax code have expanded significantly over the last 15 years, almost tripling their share of total federal higher education funding (from 3.6% to 10.5%) between 1997 and 2011. In 2011, more people received some form of higher education tax benefit (13.1 million) than received Pell Grants (9.4 million) or subsidized Stafford loans (10.4 million).[41]

While a number of education tax benefits provide direct financial relief via individual tax credits and deductions, others provide help through incentives for college saving or through the exclusion of grants, scholarships, or employer-provided assistance from taxation. Still other federal education tax provisions provide assistance to institutions, donors, and investors, rather than students and their families. In fact, one-third of the value of all federal education tax benefits (almost $10 billion) went to such recipients in 2011.[42]

Research shows that tax benefits are less effective than grants and loan subsidies at altering behavior, particularly because students and families receive tax benefits long after they have had to pay for the education. In other words, tax benefits go to students and families who have already found a way to pay the up-front costs of college. In contrast, financially needy students unable to cover tuition, books, food, housing, and transportation costs are unlikely to be influenced by the potential for future tax relief, because their focus is on the crucial expenses that need to be paid right away.[43]

In addition, unlike grant aid or subsidized loans, tax benefits disproportionately accrue to upper-middle- and higher income families, whose children are already the most likely to attend and complete college. An estimated 93 percent of those eligible for higher education tax benefits would have enrolled in college without them.[44] In contrast, research has shown that the most effective financial aid is targeted to students who would otherwise be unlikely or unable to enroll in or complete college, such as moderate- and low-income students.[45]

Lastly, the current higher education tax benefits are complex, confusing, and duplicative. It takes the Internal Revenue Service (IRS) 87 pages to explain them all and how they do and do

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[41] College Board. 2012. *Trends in Student Aid 2012*. http://trends.collegeboard.org/student-aid. Figure 7a.

[42] Calculations by the Center on Budget and Policy Priorities on data from the Joint Committee on Taxation, *Estimates Of Federal Tax Expenditures For Fiscal Years 2011-2015*. https://www.jct.gov/publications.html?func=startdown&id=4386.

[43] Long, Bridget T. 2004. "The Impact of Federal Tax Credits for Higher Education: College Choices: The Economics of Where to Go, When to Go, and How to Pay For It." Pp. 101-168 in *College Choices: The Economics of Where to Go, When to Go, and How to Pay For It*, edited by Caroline M. Hoxby. Chicago, IL: University of Chicago Press. http://www.nber.org/chapters/c10099.pdf.

[44] Turner, Nicholas. 2010. *The Effect of Tax-Based Federal Student Aid on College Enrollment*. National Tax Journal. Vol. 64, No. 3. http://bit.ly/XsiNUI.

[45] Center on Budget and Policy Priorities. 2012. Unpublished memo. Also see: Heller 1997. Dynarski, Susan. Testimony before the U.S. Senate Committee on Finance. Delivered July 25, 2012. Center on Budget and Policy Priorities. 2007. *Making Higher Education Tax Credits More Available To Low- And Moderate-Income Students: How and Why*. http://www.cbpp.org/cms/?fa=view&id=265. U.S. Department of Education. 2011. *Federal Education Tax Benefits: Who Receives Them and to What Extent Do They Shape the Price of College Attendance?* http://nces.ed.gov/pubs2012/2012212.pdf. Long 2004.

not interact.[46] A recent Government Accountability Office (GAO) report to Congress found that over *half* of all tax filers likely eligible for a higher education benefit failed to claim one at all or chose a less optimal benefit than they were qualified for.[47]

Ultimately, the timing, targeting, and complexity of existing higher education tax benefits render them less efficient and effective than other aid at increasing enrollment and completion. Moreover, to the extent that tax benefits might be offset by a reduction in grant aid, as one study found, they are not only inefficient at increasing enrollment and completion, but ineffective at reducing cost for the recipient.[48]

Improvement in financial aid programs is desperately needed.

Based on our review of available research, there are a number of areas where financial aid programs need major improvement to be more effective in increasing college access and success. In particular:

- Available need-based grant aid is insufficient to overcome gaps in access and success.
- Students and families lack sufficient information about costs, financial aid, and outcomes to make fully informed decisions about which colleges to apply to and attend.
- The complexity of the current federal aid application process and programs undermines their effectiveness.
- Colleges and states are not held sufficiently accountable for ensuring that their students receive a quality education and can complete without burdensome debt.
- Changes to financial aid programs have not consistently prioritized access and success for financially needy students.

Available need-based grant aid is insufficient to overcome gaps in access and success.

Though the cost of tuition and fees typically generates the most interest from policymakers, media, and the public alike, students also have to cover the full cost of attendance, which includes books, housing, food, and transportation. Although eligibility for many types of financial aid is based on the full cost of attendance, many needy students still end up with a gap

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[46] The IRS guidance on education tax benefits for 2011 is 87 pages. See IRS Publication 970 at http://www.irs.gov/pub/irs-pdf/p970.pdf.

[47] White, James R. and George A. Scott, U.S. Government Accountability Office (GAO). "Higher Education: Improved Tax Information Could Help Families Pay for College." Testimony before U.S. Senate Committee on Finance. Delivered on July 25, 2012. http://www.gao.gov/products/GAO-12-863T.

[48] Turner, Nicholas. 2010. *Who Benefits From Student Aid? The Economic Incidence of Tax-Based Federal Student Aid.* http://www.escholarship.org/uc/item/7gt888mj.

between available resources and the cost of attendance. As noted earlier, research has shown this unmet need to negatively influence the likelihood of enrolling in and completing college.[49]

Fully three-quarters of full-time undergraduate students have some amount of unmet need that they must find a way to cover with loans or earnings from working while enrolled. Lower income students are the most likely to have unmet need: 99 percent of full-time students who receive a Pell Grant have an average of $12,000 left to cover after taking all grants into account, and 86 percent of Pell Grant recipients still have an average of $8,500 unmet after subtracting federal loans and work-study.[50] How individual students cover these costs varies, but many do so in ways that jeopardize their educational or financial future, such as working multiple jobs while enrolled full time or taking out risky private student loans.

While recent increases to the maximum Pell Grant have been important steps forward, they have been insufficient to stop the decline in the grant's purchasing power. The maximum grant in 2012-13 covers the lowest share of college costs since the start of the program, representing less than one-third (31%) of what it costs to attend a public four-year college. This is less than half of the purchasing power the grant had in the late 1970s, when it covered between 69 and 84 percent of costs.[51] When Pell Grants cover smaller shares of costs, students end up paying for the difference using loans or work, taking fewer courses, or dropping out.

In a 2008 working paper documenting the extent of unmet need and its implications for financial aid policy, Bridget Terry Long states:

> Given these patterns of unmet need, questions about the effectiveness of the current system of financial aid often focus on whether current amounts are adequate.... Although billions of dollars are spent each year on financial aid, the above unmet need figures suggest the current amount of funding may not be enough.... Reviews of the research literature should keep in mind this reality and consider how inadequate funding levels may limit the effectiveness of current forms of aid. However, decisions about the best ways to expand the aid system should be principally guided by what is known about the particular designs and types of aid that are most effective.[52]

Investing in ineffective programs is a poor use of resources, but insufficient investment can render even the best programs ineffective. We need to deepen our investment in need-based grant aid, along with requiring that states and colleges do their share, to help close income gaps in college access and success.

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[49] Noel-Levitz 2007 and Titus 2006.

[50] Calculations by TICAS on data from the U.S. Department of Education, 2008 National Postsecondary Student Aid Study (NPSAS).

[51] College costs defined here as average total tuition, fees, room, and board costs at public four-year colleges. Calculations by TICAS on data from the College Board, 2012, *Trends in College Pricing 2012*, Table 2, http://bit.ly/14Ofvbv, and U.S. Department of Education data on the maximum Pell Grant.

[52] Long 2008.

Students and families lack sufficient information about costs, financial aid, and outcomes to make fully informed decisions about which colleges to apply to and attend.

There is widespread confusion about college costs and the availability of financial aid, which can lead students and families to inadvertently choose colleges they cannot afford, or price themselves out of higher education when it is actually within their reach. Students and families have been found to overestimate the cost of college[53] and a recent survey found that a majority of students rule out colleges based on "sticker price" alone, without considering financial aid.[54] Notably, students from lower- and middle-income families are more likely than affluent students to rule out colleges based on published prices. In another recent survey, half of low-income families eliminated colleges based on cost before doing any research on them.[55]

The lack of high-quality and meaningful data on cost and aid is a problem. Recent efforts to provide early estimates of college costs and financial aid eligibility have been a step in the right direction, but still have room for substantial improvement. For instance, almost all U.S. colleges and universities are now required to have "net price calculators" on their websites to help students and their families understand how much they would have to earn, save, or borrow to go to that school. Although these tools have promise, many net price calculators are not currently easy for prospective students to find, use, and compare.[56]

In addition to the inadequacy of early estimates of financial aid, there is a lack of clear and meaningful information from colleges about aid and student outcomes. Existing disclosure requirements are often ineffective, in part because they are frequently ignored by colleges or met in a way that confounds rather than enlightens consumers.[57] Further, holes in available data make it difficult or even impossible to learn about cumulative debt or job placement rates for colleges or programs.[58] These are critical questions for students considering a college, but data limitations prevent them from finding meaningful and comparable answers.

This lack of information is a problem because there is such wide variation in college costs and college outcomes, and higher cost colleges do not always deliver the best outcomes. For

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[53] Grodsky, Eric and Melanie Jones. 2004. *Real and Imagined Barriers to College Entry: Perceptions of Cost.* Social Science Research. Vol. 36. U.S. Department of Education. 2003. *Getting Ready to Pay for College: What Students and Their Parents Know About the Cost of College Tuition and What They Are Doing to Find Out.* http://nces.ed.gov/pubsearch/pubsinfo.asp?pubid=2003030.

[54] The College Board and Art & Science Group, LLC. 2012. *A Majority of Students Rule Out College Based on Sticker Price Students Do Not Take into Account Their Likely Financial Aid Award and Its Impact on Net Cost.* Student Poll Vol. 9, Issue 1 http://www.artsci.com/studentpoll/v9n1/index.html.

[55] Sallie Mae. 2012. *How America Pays for College 2012.* http://bit.ly/WV5wzT.

[56] TICAS. 2012. *Adding It All Up 2012: Are College Net Price Calculators Easy to Find, Use, and Compare?* http://ticas.org/files/pub/Adding_It_All_Up_2012.pdf.

[57] The American Enterprise Institute and Education Sector. 2011. *The Truth Behind Higher Education Disclosure Laws.* http://www.aei.org/files/2011/11/07/-truthhighereddisclosurelaws_185621335060.pdf.

[58] U.S. Department of Education, National Postsecondary Education Cooperative. 2011. *Suggestions for Improvements to the Collection and Dissemination of Federal Financial Aid Data.* http://nces.ed.gov/pubs2012/2012834.pdf. See also the White House College Scorecard, a one-page snapshot intended to "make it easier for students and their families to identify and choose high-quality, affordable colleges that provide good value." Multiple sections of the scorecard are blank due to lack of data: http://www.whitehouse.gov/issues/education/higher-education/college-score-card. Accessed January 18, 2013.

example, many of the colleges that charge low-income students the most have low graduation rates. In fact, more than 94 percent of low-income students at for-profit colleges attend schools where they have to contribute more than 100 percent of their average household income (about $17,000) and have a less than a one-in-four chance at graduating.[59] They may not have known that better and more affordable options are available.

Research shows that providing students and families with clear information about costs and outcomes can help them make better decisions about college. Getting information about costs and financial aid has been found to increase students' and parents' college-going aspirations,[60] and adding graduation rates to comparisons of two otherwise similar colleges can have an impact on parent preferences.[61] Further, students who write off selective colleges based on sticker price may undermine their chances of earning a degree by "undermatching," or choosing a less selective college than they are academically qualified to attend.[62] Providing the information students and families need to make meaningful comparisons supports their ability to find the college that is the best fit, increasing the probability that students thrive and graduate.

The complexity of the current federal aid application process and programs undermines their effectiveness.

As a result of the complexity of our current financial aid system, students are missing out on aid they would likely be eligible for. Nationally, an estimated 2.3 million students were eligible for a Pell Grant but did not complete the Free Application for Federal Student Aid (FAFSA) in 2007-08.[63]

The FAFSA is universally criticized for being too complex, and understandably so. With only slightly fewer questions than the full 1040 federal income tax form,[64] the sheer number and detail of required questions in the FAFSA can be daunting, particularly for students who are least familiar with the financial aid process. The relatively new IRS Data Retrieval tool is an

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[59] The Education Trust 2011.

[60] Oreopoulos, Philip and Ryan Dunn. 2012. *Information and College Access: Evidence from a Randomized Field Experiment.* National Bureau of Economic Research. Working Paper 18551. http://www.nber.org/papers/w18551. The College Board Advocacy & Policy Center. 2010. *Cracking the Student Aid Code: Parent and Student Perspectives on Paying for College.*

http://advocacy.collegeboard.org/sites/default/files/11b_3172_Cracking_Code_Update_WEB_110112.pdf. Zarate, Maria Estela and Harry P. Pachon. 2006. *Perceptions of College Financial Aid Among California Latino Youth.* Los Angeles, CA: Tomas Rivera Policy Institute (TRPI).

[61] American Enterprise Institute. 2011. *What Parents Don't Know about College Graduation Rates Can Hurt.* http://bit.ly/W2GMYd.

[62] Bowen, Chingos, and McPherson 2009. The University of Chicago Consortium on Chicago School Research. 2009. *From High School to the Future: Making Hard Work Pay Off.* http://ccsr.uchicago.edu/publications/high-school-future-making-hard-work-pay.

[63] Kantrowitz, Mark. 2009. *Analysis of Why Some Students Do Not Apply for Financial Aid.* http://www.finaid.org/educators/20090427CharacteristicsOfNonApplicants.pdf.

[64] Dynarski, Susan and Mark Wiederspan. 2012. *Student Aid Simplification: Looking Back and Looking Ahead.* National Bureau of Economic Research. Working Paper 17834. http://www.nber.org/papers/w17834.

important step forward in simplifying the application process, but it still has major limitations and needs improvement before it can be used by all applicants.[65]

Simplifying the aid application process can have a large effect on enrollment and the receipt of financial aid, which in turn affects persistence. An experimental program conducted in partnership with H&R Block found that students who have more information about aid and receive assistance completing the FAFSA are substantially more likely to submit the aid application, enroll in college the following fall, and receive more financial aid than those who do not receive assistance and information.[66] Specifically, the program increased enrollment among high school seniors, recent high school graduates, and low-income adults with no prior college experience.

Importantly, research shows that the FAFSA can be simplified without serious negative side effects on targeting or eligibility for other aid programs. A recent analysis found that most of the questions on the FAFSA could be eliminated and the process aligned to IRS tax returns without losing very much in terms of targeting the aid to needy students.[67] Another analysis suggests that FAFSA simplification would have only a minimal effect on students' eligibility for state financial aid.[68] Simplifying the FAFSA, particularly through further improvements to the IRS data transfer, would also reduce burden for colleges and universities by streamlining the verification process.[69]

Further, as discussed earlier, the complexity of federal grants, loans, and tax credits confuses students and families and blunts the impact of those programs. Students cannot respond to a benefit that they do not know about, and cannot make optimal choices without understanding their options. This complexity also confounds researchers seeking to document the effectiveness of federal aid expenditures.

Colleges and states are not held sufficiently accountable for ensuring that their students receive a quality education and can complete without burdensome debt.

Current federal policies hold students accountable for studying hard and making continued progress toward their educational goals.[70] To maintain eligibility for federal financial aid,

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[65] For more information, see TICAS' comments to the U.S. Department of Education on the proposed 2011-12 FAFSA materials: http://www.ticas.org/files/pub/2011-12_Federal_Student_Aid_Application_comments_15Nov2010.pdf.

[66] Bettinger, Eric, Bridget Terry Long, Philip Oreopoulos, and Lisa Sanbonmatsu. 2009. *The Role of Simplification and Information in College Decisions: Results from the H&R Block FAFSA Experiment.* National Bureau of Economic Research. Working Paper 15361. http://www.nber.org/papers/w15361.

[67] Dynarski and Wiederspan 2012, building. Dynarski and Wiederspan 2012 built upon previous work by Dynarski, Susan, and Judith Scott-Clayton, 2006. *The Cost of Complexity in Federal Student Aid: Lessons from Optimal Tax Theory and Behavioral Economics.* National Tax Journal Vol. 59, No. 2.

[68] The College Board. 2012. *Simplifying Student Aid: What It Would Mean for States.* http://advocacy.collegeboard.org/sites/default/files/12b_5073_State_Simplicication_Report_FINAL.pdf.

[69] For more information, see TICAS. 2010. *After the FAFSA: How Red Tape Can Prevent Eligible Students from Receiving Financial Aid.* http://ticas.org/files/pub/AfterFAFSA.pdf.

[70] For more information, see TICAS. 2011. *Pell Grant Provisions Prevent Student Abuse.* http://ticas.org/files/pub/Protections_against_Pell_abuse_one-pager_July_18-_updated.pdf.

students must make "satisfactory academic progress" (SAP). Under federal SAP guidelines, which were strengthened in 2011, students must complete at least two out of every three units attempted with a grade of "C" or better, and colleges must assess all federal aid applicants to ensure that they are making adequate progress toward a credential for students to receive federal aid. College guidelines may be stricter. Federal rules also require students who either drop out or drop most of their courses after receiving federal aid to repay what they did not earn—and they are not eligible for more aid until they do.

However, there are few consequences for schools that fail to graduate large shares of students or leave students with excessive debt and/or degrees that have little value in the job market. Particularly in an era of limited resources, the federal government should not distribute financial aid dollars to poorly performing schools. The data are clear that some schools have a much better track record than their peers of enrolling and graduating low-income students, while maintaining a manageable cost.[71] Attaching better accountability measures to institutional eligibility for federal financial aid can help redirect resources efficiently and incentivize schools to improve outcomes for their students.

Student outcomes vary considerably, even among similar colleges. For example, among open-admission colleges, where all applicants are admitted, graduation rates vary greatly from school to school and sector to sector. A 2010 report by The Education Trust found that the graduation rates at open-admission four-year for-profit colleges were on average about three times lower than the rates at open-admission public and nonprofit four-year colleges (11% compared to 31% and 36%, respectively).[72] This is particularly problematic because students attending for-profit colleges are more likely to borrow than students attending other types of colleges.[73]

Recent efforts to increase accountability for colleges have not been sufficient. In particular:

- In 2008, Congress strengthened the calculation of colleges' "cohort default rates" (CDRs), which measure how many of a college's borrowers default, or fail to make any payments on their loans for at least nine months, within a certain period of time after they leave school. Congress strengthened the calculation by extending the period of time during which borrowers were tracked, from two years to three years, while moderating the impact by raising allowable default levels.[74] However, some colleges are taking steps to

[71] The Education Trust 2011.

[72] The Education Trust. 2010. *Subprime Opportunity: The Unfulfilled Promise of For-Profit Colleges and Universities.* http://www.edtrust.org/sites/edtrust.org/files/publications/files/Subprime_report_1.pdf. This study measured six-year graduation rates at four-year colleges.

[73] Abernathy, Pauline. TICAS. Testimony before the U.S. Senate Health, Education, Labor, and Pensions Committee Hearing on "Drowning in Debt: Financial Outcomes of Students at For-Profit Colleges." Delivered June 7, 2011. http://projectonstudentdebt.org/files/pub/Abernathy_testimony_June_7_2011.pdf.

[74] U.S. Department of Education, Office of Postsecondary Education. 2008. *The Higher Education Act.* DCL GEN-08-12. http://www.ifap.ed.gov/dpcletters/GEN0812FP0810.html.

mask high default problems and manipulate their default rates in ways that help colleges, not students.[75]

- The U.S. Department of Education's (the Department's) final "gainful employment" rule, issued in June 2011,[76] was substantially weaker than the draft rule and is currently on hold due to a court ruling.[77] This rule would have enabled enforcement of longstanding federal law requiring postsecondary career education programs (offered at public, nonprofit, and for-profit colleges) receiving federal financial aid to "prepare students for gainful employment in a recognized occupation."

States as well as colleges must also be held more accountable to ensure that they are adequately supporting their students. More than three-quarters of undergraduate students (76%) attend public colleges, which awarded 75 and 64 percent of associate's and bachelor's degrees, respectively, in 2010.[78] Because public higher education is primarily funded and managed at the state level, federal policy intended to affect college affordability and student debt levels must also take into account state-level funding policy. A decades-old trend of state disinvestment in public higher education accelerated dramatically during the economic crisis. Per-student state funding at public institutions fell more than 25 percent from 2007 to 2011 and is currently at its lowest level in over 25 years.[79] This sharp decline in public subsidy levels has been the largest driver of recent tuition increases at public institutions,[80] which have significantly decreased affordability and increased student debt.[81]

Given state funding trends,[82] federal maintenance of effort (MOE) provisions, which tie certain amounts of federal support to a required minimum level of state investment, have become a powerful way to encourage states to maintain funding for higher education. MOE provisions were included in the American Recovery and Reinvestment Act (ARRA) State Fiscal

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[75] TICAS. 2012. *Steps the Education Department Should Immediately Take to Curb Default Rate Manipulation.* http://ticas.org/files/pub/TICAS_memo_on_CDR_evasion_082112.pdf.

[76] U.S. Department of Education. June 2, 2011. Press release. "Obama Administration Announces New Steps to Protect Students from Ineffective Career College Programs. Gives Programs Every Chance to Improve While Holding Them Accountable." http://www.ed.gov/news/press-releases/gainful-employment-regulations.

[77] TICAS. July 2, 2012. Blog post. "Court Strikes Down Low "Gainful Employment" Repayment Rate Standard but Affirms Education Department's Authority to Act and the Need to Do So." http://views.ticas.org/?p=884.

[78] U.S. Department of Education, National Center for Education Statistics. 2012. *The Condition of Education 2012.* "Indicator 46: Degrees Conferred by Public and Private Institutions." http://nces.ed.gov/programs/coe/pdf/coe_dai.pdf. U.S. Department of Education, National Center for Education Statistics. 2012. *The Condition of Education 2012.* "Indicator 36: Characteristics of Undergraduate Institutions." http://nces.ed.gov/programs/coe/pdf/coe_psi.pdf.

[79] Calculations by TICAS on data from the College Board, *Trends in College Pricing 2012,* Figures 12A and 12B. http://trends.collegeboard.org/sites/default/files/CP%20Figure%2012AB%20011013_0.xlsx.

[80] Delta Cost Project at the American Institutes for Research. 2012. *Spending, Subsidies, and Tuition: Why are Prices Going Up? What are Tuitions Going to Pay For?* http://www.deltacostproject.org/resources/pdf/Delta-Subsidy-Trends-Production.pdf. Figure 3.

[81] TICAS. 2012. *Student Debt and the Class of 2011.* http://projectonstudentdebt.org/files/pub/classof2011.pdf.

[82] Although the most recent Grapevine survey of state support for public higher education in 2012-13 shows a slowing of the average reduction in support for higher education, the large hole between previous and current levels of support remains and it is expected that the "new normal" for state funding of higher education will take a long time to reverse, if ever. For more information, see http://live.sheeo.gotpantheon.com/sites/default/files/publications/Grapevine_Release_FY13_Jan16.pdf.

Stabilization Fund in 2009 and in the Education Jobs Fund in 2010 and were widely seen as effective in protecting higher education funding from even deeper state funding cuts that would have otherwise occurred, with 15 states cutting funding to within one percent of the federally required minimum funding level during the years the requirements were in effect.[85]

Changes to financial aid programs have not consistently prioritized access and success for financially needy students.

There is tremendous room for improvement in the way that changes are proposed and made to financial aid programs. Too many financial aid policy changes are adopted based on the short-term savings they produce, with too little focus on their impact on students, unintentionally undermining the goals of college access and success.

As a case in point, consider the recent creation of a retroactive, six-year lifetime eligibility limit for Pell Grants.[86] In 2008, Congress limited Pell Grant eligibility to nine years and applied the limit prospectively - to students receiving a Pell Grant for the first time on or after July 1, 2008.[87] In December 2011, after virtually no public deliberation, Congress lowered this lifetime limit to six years and applied it *immediately and retroactively* to all students, including those a semester away from completing their degrees.[88] Because this change was applied retroactively, students did not have an opportunity to adjust their behavior and many were left scrambling to try to replace the financial aid funds they had been counting on.

Based on data from the Congressional Budget Office (CBO), during the 2012-13 year alone this immediate and retroactive lifetime limit made more than 100,000 students permanently ineligible for a Pell Grant. This change is expected to disproportionately harm African-American students and students enrolled at public and nonprofit four-year colleges, and will make it harder for students who were required to take remedial or developmental courses to complete.

Recent reports have already begun to quantify the impact at the state and college levels. In Alabama, the new lifetime eligibility limit led to an estimated 4,731 public college students losing their Pell Grants in fall 2012.[89] Another 12,057 Alabama students will likely lose Pell Grant eligibility in the next two semesters. In Mississippi, the new lifetime eligibility limit, along with two other changes to the Pell Grant program, led to enrollment decreases at 14 out of 15 of

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[85] American Association of State Colleges and Universities (AASCU). 2012. *Update on the Federal Maintenance of Effort Provision: Reinforcing the State Role in Public Higher Education Financing*. http://www.aascu.org/policy/publications/policy-matters/2012/MaintenanceofEffort-II.pdf.

[86] For more information, see *Impact of the Immediate and Retroactive Lower Lifetime Limit for Pell Grants*: http://ticas.org/files/pub/Retroactive_6yr_Pell_lifetime_limit_06-19-12.pdf.

[87] Higher Education Opportunity Act. Public Law 110-315, August 14, 2008. http://www.gpo.gov/fdsys/pkg/PLAW-110publ315/pdf/PLAW-110publ315.pdf

[88] Consolidated Appropriations Act 2012, Public Law 112-74, http://www.gpo.gov/fdsys/pkg/BILLS-112hr2055enr/pdf/BILLS-112hr2055enr.pdf.

[89] Katsinas, Stephen, Nathaniel Bray, Jonathan Koh, and Phillip Grant, commissioned by the Alabama Commission on Higher Education. 2012. *A Study of Pell Grants in Alabama*. http://1.usa.gov/VKYNh4.

the state's community colleges in fall 2012.[88] Almost 3,000 Mississippi students lost Pell Grant eligibility in fall 2012 and more than 7,000 more are expected to lose eligibility in the next several semesters. Community colleges in other states are also reporting enrollment declines and students losing part or all of their grants.[89] As Mississippi State Senator Terry Burton (R-Newton), the vice chairman of the state's Senate Universities and Colleges Committee, commented, "When someone runs out of money on a grant eight hours before they've finished a degree, that's bad for them, bad for the university, bad for everybody."[90]

Unfortunately, this form of policymaking – generate savings first and assess impacts later – is not uncommon. In recent years, the economic downturn has contributed to a climate where the need for near-term savings has driven policy discussions, pushing the long-term need for investment in higher education and financial aid into the backseat. Examples of harmful policy proposals at the state and federal levels that were considered and, unlike the retroactive lifetime limit discussed above, not enacted, include:

- **Redefining "full time" for Pell Grants.**[91]
  During budget negotiations in the summer of 2012, some suggested requiring students to take 15 credits, rather than 12 credits, to be considered "full time" and thus be eligible for the maximum Pell Grant. This change would have reduced college access by cutting millions of students' grants by up to $1,400 a year. Purportedly intended to increase college completion, this proposal did not take into account students' inability to take 15 credits per term due to course capacity constraints, work and family commitments, and other restrictions.

- **Instituting an income cap for Pell Grants that ignores family size.**[92]
  The House Fiscal Year 2013 budget resolution proposed implementing an unspecified maximum income cap for Pell Grants, above which students would no longer be eligible for Pell Grants, regardless of their family size or situation. However, the federal needs analysis formula already targets Pell Grants toward the neediest students. A maximum income cap would have simply cut off Pell Grants to needy students from large families.

- **Ratcheting up merit criteria for California's Cal Grants.**[93]
  In his 2012-13 budget proposal, California Governor Jerry Brown recommended

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[88] Quoted in Lane 2013.

[89] Snyder, Susan. January 11, 2013. "Pell grant changes hit community college students hard." *Philadelphia Inquirer*. http://articles.philly.com/2013-01-11/news/36260619_1_pell-grants-pell-eligibility-financial-aid/.

[90] Quoted in Lane, Emily. January 10, 2013. "New Pell Grant restrictions resulted in lower enrollment at 14 of the state's 15 community colleges." *Clarion Ledger*. http://on.thecl.com/V3kul.

[91] For more information see *Redefining "Full-Time" for Pell Grants Reduces College Access*: http://www.clasp.org/admin/site/documents/files/Redefining-Full-Time-for-Pell-Grants-Reduces-College-Access.pdf.

[92] For more information, see *An Arbitrary Maximum Income Cap Would Eliminate Pell Grants for Needy Students*: http://ticas.org/files/pub//Max_income_cap_for_Pell_in_House_FY13_Budget_07-15-12.pdf. For analyses of other recent Pell Grant proposals, see http://ticas.org/pellgrant_resources.vp.html.

[93] For more information, see *Cal Grant GPA Increases Would Hurt College Completion Rates*: http://ticas.org/files/pub/CG_GPA_Increase_3-06-12.pdf.

substantially raising the grade point average (GPA) thresholds required to receive new Cal Grants. This change would have locked out more than a third of applicants currently eligible for the main type of grant - particularly those whose college access and success are most likely to be enhanced with a Cal Grant. This proposed change was not based on adequate evidence, overlooked major unintended consequences, and would have hit low-income and underserved students the hardest. It was eventually dropped from the California budget.

Rethinking federal student aid to prioritize student access and success requires that we reexamine how financial aid policies are considered, implemented, and modified. A well-designed system of financial aid promotes access and success through a combination of informational and financial supports, built upon each other to enable all willing students to seek and complete a postsecondary credential. Changes made in a vacuum serve to undermine the effectiveness of such a system. Moving forward, we must reject shortsighted policy changes that put savings first and students last.

Principles for federal student financial aid reform.

The following principles are based on our analysis of the existing research and evidence, which is summarized above. The policy recommendations in this white paper are based on these principles.

Affordable. Federal aid should ensure that all students willing to study hard can afford to go to college.

Shared Accountability. Federal aid should hold students accountable for studying hard and making continued progress towards their educational goals, *and* should hold states and schools accountable for ensuring that their students receive a quality education and can complete without burdensome debt.

Adequate and Effective Investment. Federal investments need to be both adequately funded and effectively structured to maximize student access and support success.

Simpler. Federal aid needs to be easy for students to understand and use, and minimize the administrative burden on schools.

Better Information. Clear and timely information about costs, aid, and outcomes is necessary for students to make wise college decisions and to foster competition among colleges to keep costs down.

Timing Matters. To best support access and success, aid should be provided when students need to pay for college costs rather than after the fact.

How Changes are Made. Changes in federal aid policies should be:

- Designed to prioritize access and success for financially needy students.
- Grounded in relevant evidence.

- Made in the open after public deliberation and input.
- Made with great care if the potential harm to students is significant.
- Designed to minimize the risks of waste, fraud, and abuse.

Section 2: Student Eligibility and Accountability

How students and their families find out about, apply for, and qualify for aid all have direct implications for both access and success. As discussed more in Section 1, if they do not know they are eligible for aid, or for how much, they may assume they cannot afford college or that there is no point in applying for aid. However, knowing they are probably eligible for a certain amount of aid is not enough. If the application process is daunting, they may not receive the aid that could help them start and stay in school. In addition, the parameters used to determine eligibility have implications for early awareness, the application process, the distribution of available aid, and how aid recipients are held accountable. There are clear opportunities for improvements to both the application process and the parameters used.

It is important to note that there is no perfect system for determining just how much someone can or should pay for college, or how much aid they should receive. The "needs analysis" formula used to determine federal aid eligibility is an attempt to *predict* what students and their families will be able to afford when they actually have to pay the bills. In some cases, attempts to draw fine distinctions between the poor and the very poor create the highest barriers for those with the greatest financial need and the least support for getting through the process.

The complexity of the Free Application for Federal Student Aid (FAFSA) reflects the complexity of the federal needs analysis formula, but it is possible to simplify the application process regardless of the formula. An analogy is that a word-processing program can be very easy to use even if the underlying code is extremely complex. When considering aid reform, it is imperative to separate these two related but distinct issues: the complexity of the *application process*, which influences how students learn about, apply for, and qualify for aid; and the complexity of the *needs analysis formula*, which serves to direct available aid to specific applicants. We recommend improvements to both below.

To better ensure access and support success, we propose the following reforms to simplify the aid application process and better target available aid, as well as support early awareness:

- Simplify the aid application process
    - Calculate aid eligibility using the tax or W-2 data available when students typically apply to college.

- Streamline the verification process to increase the odds that qualified students receive the aid they applied for.

- Better target available aid and prevent fraud

    - Increase the share of questions that can be answered automatically with Internal Revenue Service (IRS) data.

    - Adjust elements of the needs analysis formula to improve aid targeting.

    - Strengthen student accountability measures that support persistence and completion.

Simplify the aid application process.

There have been tremendously positive changes to the online FAFSA in recent years. Millions of applicants have been able to electronically transfer their tax information into the FAFSA, a system based on our 2007 recommendations for simplifying the aid application process.[illegible] With the applicant's consent, the IRS Data Retrieval Tool can prepopulate and update answers to more than 20 high-stakes questions on the 2013-14 FAFSA. And once an applicant is identified as an independent student, "skip logic" eliminates additional questions aimed at determining dependency status or collecting parental information.

While the IRS Data Retrieval Tool has been instrumental in streamlining the FAFSA completion process for many students and parents, further improvements are needed to better serve all applicants.

Calculate aid eligibility using the tax or W-2 data available when students typically apply to college.

Currently, FAFSAs for the 2013-14 academic year require applicants' tax data from 2012. This causes several significant timing problems with the current application process, which make it harder for students to get the aid they need and make informed decisions about college. They involve misalignments on multiple fronts: the date that the FAFSA first becomes available; the data it currently requires; and the various deadlines for applying to college, applying for state grants and other types of aid, filing federal income tax forms, and making final choices about which college to attend.

Fixing these timing problems would improve access to needed aid and support more informed decisions about where to go to college and how to pay, and they can all be reduced or eliminated by adjusting the tax year used to predict a student's ability to pay to an earlier year (e.g. using 2011 tax data for academic year 2013-14, instead of 2012 tax data). The table below details how such a change would help to solve a number of well-documented timing problems.

[illegible] For more information, see TICAS. 2007. *Going to the Source: A Practical Way to Simplify the FAFSA.* http://www.ticas.org/pub_view.php?idx=232.

Current Timing Problem	The Improved Timing Solution
You cannot apply for federal student aid until January of the coming academic year, even though college applications may be due earlier. For example, the FAFSA for 2013-14 was not available until January 1, 2013 because it requires tax data from the year that just ended. Meanwhile, many four-year college applications were due by December 31, 2012. That means many students decided whether and where to apply to college without knowing if they qualified for federal aid.	Students and families could apply for aid before or when they apply to college. With earlier and more robust aid estimates, aid application and determination could potentially happen as soon as spring of a high school student's junior year.
While you can apply for aid as soon as January 1, the process currently requires tax information from the year that just ended. Employees may not get their W-2 forms until the end of January, and federal tax returns are not due to the IRS until mid-April. However, many state grant programs have deadlines that fall well before federal taxes are due (e.g., Connecticut's is February 15, California's is March 2), and some sources of state and college aid are first-come, first-served.	With earlier access to the requisite tax data, students could more easily meet deadlines for state grants and other sources of aid.[illegible]
Applicants can use estimates to submit a FAFSA while waiting until their tax return is filed, but they will not be able to confirm aid eligibility or amounts until they update the information. They may also be subject to verification procedures that create further delays and obstacles to receiving the aid they qualify for.	Having readily available tax data would eliminate the need to use estimates on the FAFSA. Financial aid counselors could spend less time verifying students' eligibility and more time helping students navigate the aid process, advising them about their options, and assessing whether recent changes in financial circumstances affect their eligibility for aid.
The IRS Data Retrieval Tool only helps applicants whose required tax information is already in the IRS' electronic records. It can take up to two weeks for an electronically filed 1040 form to become available for data retrieval, and up to eight weeks if the 1040 was filed on paper.	Tax data would be readily available for electronic transfer when students first apply, increasing successful use of the IRS Data Retrieval Tool. By reducing the need for estimation, updating, and verification, this simplifies the FAFSA and reduces uncertainty for students while also reducing administrative burdens for schools. It is estimated to cost schools an average of more than $100 to put a student through verification.[illegible]
Currently, people who do not file a 1040 because they earn too little to owe federal income tax face the largest paperwork burden when they apply for federal student aid. They do not benefit from the IRS Data Retrieval Tool because it draws information only from 1040 forms. While the IRS can send "W-2 transcripts" to colleges for verification purposes, W-2 data cannot currently be used in the IRS Data Retrieval Tool. One of the possible reasons for this omission is that W-2 data may take longer than 1040 data to become available.	Using a readily available year of tax data for the FAFSA would allow the very lowest income students to benefit from a streamlined application process.

[illegible] To benefit from this change, some states may need to change their state aid program rules to better align with the federal application process, as discussed below.

[illegible] TICAS. 2010. *After the FAFSA: How Red Tape Can Prevent Eligible Students from Receiving Financial Aid.* http://ticas.org/files/pub/AfterFAFSA.pdf.

Each of these problems is distinct, but they share the same solution: using an earlier – and therefore readily available – year of tax data to estimate students' and families' ability to pay college costs. Doing so will let students apply for aid earlier and better understand their eligibility before they and their families make decisions about whether and where to apply to college. It will also improve the process for the lowest income applicants, who are most likely to be targeted for verification, and increase their chances of receiving the aid for which they are eligible. Using an earlier year of data could also help clear the way for non-tax-filers' W-2 income information to be electronically transferred into the FAFSA as tax-filers' income information already is. We strongly recommend allowing non-tax-filers to benefit from the Data Retrieval Tool in this way.

Using the data available in the fall will greatly simplify the aid application process while still effectively targeting aid. Analyses have found that using the earlier year of data (sometimes referred to as "prior-prior year") instead of the year currently used (often referred to as "prior year") would have minimal effects on Pell eligibility for most applicants.[47] Still, even the current system of using prior year data does not create perfect estimates of families' ability to pay. Historical tax data simply cannot be used to predict with total accuracy the resources students and families will actually be able to put towards college during the next academic year. However, evidence suggests that prior-prior income is nearly as good as doing so as prior year income. A U.S. Department of Education (Department) analysis of financial aid applications found that prior-year income was 87 percent predictive of current year income, and prior-prior year income was close at 82 percent.[48]

The increased efficiency and resulting access to aid outweigh the minor eligibility changes that would occur from using an earlier year of data. College financial aid offices would retain their authority to use their professional judgment and draw on more recent income information in cases where students flag substantial changes. In addition, using readily available data for all applicants would free up more of administrators' time to make such adjustments when needed, as fewer students would need assistance with estimating income information before it is available and then updating it after taxes are filed.

This change also has implications for states and colleges, which use students' tax data to allocate state and institutional financial aid.[49] For students to fully realize the benefits of this simplification, states and colleges would need to use the same year of income data as the FAFSA. Otherwise, applicants would have to provide double the amount of information they currently do (two years of information rather than one). Congress and the Department should consider how to best incentivize states to adjust their aid programs that are not already tied to whatever the FAFSA uses.

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[47] Dynarski, Susan and Mark Wiederspan. 2012. *Student Aid Simplification: Looking Back and Looking Ahead*. National Bureau of Economic Research. Working Paper 17834. http://www.nber.org/papers/w17834.

[48] U.S. Department of Education. 1998. *HEA Reauthorization Issue: Using "Prior-Prior" Year Income*. Reauthorization explanatory document.

[49] The College Board. 2012. *Simplifying Student Aid: What It Would Mean for States*. http://advocacy.collegeboard.org/sites/default/files/12b-5073_State_Simplification_Report_FINAL.pdf.

Streamline the verification process to increase the odds that qualified students receive the aid they applied for.

After the Department receives students' FAFSAs, the agency flags some applications for colleges to "verify." This process requires students to resubmit and document some or all of the information they put on their FAFSAs, which can be onerous for some students. Nearly all aid applicants selected for FAFSA verification are eligible for Pell Grants, making the application process most laborious for those who most need aid. Our research found that the verification process itself reduces the odds that eligible students will actually receive needed Pell Grants. We also found that colleges' verification policies and processes vary considerably and can be unnecessarily burdensome for both students and schools.[100]

More widespread use of the IRS Data Retrieval tool will reduce the need for verification. Still, some amount of verification will remain necessary to prevent fraud and maintain the integrity of the student aid programs. We recommend streamlining federal verification requirements and guidance to focus on areas of known or likely errors. This is in contrast to the current approach, in which the Department can effectively require colleges to verify any FAFSA element for any reason or none at all. For example, applicants who indicate that someone in their family received SNAP (food stamp) benefits in the past two years are currently being required to provide documentation, although Department officials have confirmed that there is no data to indicate common errors on this part of the FAFSA.[101]

Better target available aid and prevent fraud.

Both the application process and the underlying formula affect how students qualify for aid. The formula is set by Congress and includes many financial and nonfinancial elements. Congress frequently and substantially changes the needs analysis formula, at times expanding, refining, or reducing eligibility with rationales that do not necessarily take the likely impact on access or success into account. Recent years have seen reform proposals that run the gamut, from increased complexity by treating untaxed means-tested benefits (such as food stamps) as income, to dramatic simplification by eliminating the FAFSA and basing aid eligibility solely on adjusted gross income (AGI) or AGI plus family size.

While the current system has many flaws that must be addressed, it also has some important aspects that are worth preserving and strengthening in the interest of access and success. For example, financially needier students get larger grants, and grants are prorated for part-time students, avoiding steep and inequitable "cliffs" that leave students in very similar financial situations with very different levels of aid. Students and parents who do not have to file a 1040 have other ways to qualify – and could do so even more easily if W-2 data could be imported into the IRS Data Retrieval Tool as recommended above. It is also important that the formula recognizes that nominally non-financial factors such as dependency status, family size, the number of children in college, and parental age (for dependent students) play a role in how

[100] For more information, see TICAS. 2010. *After the FAFSA: How Red Tape Can Prevent Eligible Students from Receiving Financial Aid.* http://ticas.org/files/pub/AfterFAFSA.pdf.

[101] Comments of U.S. Department of Education official at the December 2011 Federal Student Aid (FSA) conference.

much someone can actually afford to pay for college. The following recommendations aim to build on such strengths.

Increase the share of questions that can be answered automatically with IRS data.

The more that data elements required for needs analysis match information the government already has, the easier it is to streamline the aid process, from providing early estimates to completing the form to preventing fraud and reducing errors and paperwork. As discussed above, this involves not only the definitions of things like income and family size, but also the year of data required and which federal sources it can be drawn from.

Research has found that AGI plus taxes paid, state of residence, family size, marital status, type of federal tax form used, and number of family members in college explains virtually all (95%) of the variation in Pell Grants. Most of this information is already collected through federal income tax forms. The exceptions are family size, which is defined differently on the 1040, and number of children in college, which families can easily answer. However, the FAFSA also asks questions about assets that are not addressed by the 1040, can be intimidating and time consuming to complete, and have little or no effect on aid determinations for lower income students. For example, question 40 on the 2013-14 FAFSA asks, "As of today, what is your (and spouse's) total current balance of cash, savings and checking accounts? Don't include student financial aid."

We recommend close consideration of ways to better align needs analysis with data available from the IRS while preserving the strengths described above. One example would be to consider defining family size so that it matches the number of IRS exemptions. Another would be to eliminate questions about assets for any applicant with less than $150,000 in relevant assets.

Any changes to needs analysis should ensure that those with the lowest incomes also have a user-friendly way to apply for aid.

Adjust elements of the needs analysis formula to improve aid targeting.

To better target aid to those with more financial need, we recommend several specific changes to the current formula:

- For applicants subject to asset questions, include the value of businesses with 100 or fewer employees in the calculation of the household's net worth. They are currently excluded solely based on the number of employees, regardless of monetary value, which results in poor targeting of aid.
- Protect income required to pay for basic needs, such as housing and food. The needs analysis formula already includes an "income protection allowance" (IPA) for this purpose, but the purchasing power of the amounts of income protected can be very low

and vary substantially between types of students.[102] We recommend instead setting this threshold at 150 percent of the appropriate poverty level for the applicant, given their dependency status and family size, so that families are not forced to choose between buying groceries and paying for college. Such a threshold would be consistent with the definition of "discretionary income" used to determine income-based payments for federal student loans, and it automatically adjusts for inflation as well as for family size. It also eliminates the current problem of two aid applicants with earnings that differ by just a few dollars being treated very differently. For context, 150 percent of poverty is $17,235 for a single adult and $35,325 for a family of four in federal fiscal year 2013.[103] This method of setting IPA thresholds better targets aid than the current auto-zero expected family contribution (EFC) threshold, which presumes families below a certain income threshold have zero dollars to spend on college regardless of their family size. It would also make it easier for students to estimate their aid eligibility.

- For students enrolled entirely in online programs, exclude transportation from the cost of attendance estimates that cap how much they can receive in grants and loans. This will help reduce the risk of waste and fraud and limit unnecessary borrowing. Students who take all of their courses online need time to attend class and study just like any other student, and aid can help make up for lost wages while enrolled, but online courses should not have any transportation costs.

Strengthen student accountability measures that support persistence and completion.

As noted in our principles for reform, students, states, and schools share accountability for student outcomes. We believe that federal aid should hold students accountable for studying hard and making continued progress toward their educational goals, just as it should hold states and schools accountable for the conditions that make such progress possible and affordable. To better target aid and promote both access and success, we propose the following improvements to federal rules:

- Students should not be better off if they drop out than if they drop classes but stay enrolled. Currently, students who start full time and have to drop all of their courses in the middle of the term are unlikely to have to give back any of their aid (Return to Title IV, or R2T4). That is because a portion of grant funds students receive is rightly protected from needing to be returned in the case of withdrawal, a provision which recognizes that students may have spent those funds on books, food, or other costs that cannot be recouped. In contrast, students who start full time and drop *most* of their courses – but not all – may owe money, and they cannot receive additional federal aid until it has been repaid (an overpayment). If students demonstrate a *pattern* of either dropping out or dropping courses, they will become ineligible for aid under rules

[102] For instance, scheduled IPA levels for 2013-14 range from 63 percent to 162 percent of poverty, depending on the student's dependency status, family size, and number of family members in college. For more information, see http://ticas.org/files/pub/IPA_Rollback_in_House_FY13_Budget_06-18-12.pdf.

[103] Calculations by TICAS using data from the U.S. Department of Health and Human Services. "2013 Poverty Guidelines." http://aspe.hhs.gov/poverty/13poverty.cfm.

requiring satisfactory academic progress (SAP). Federal aid policy should always encourage students to stay in school rather than drop out, and squeezing them out over funds used for tuition, books, or other costs that cannot be recouped is at odds with a goal of student success.

- A September 2011 report of the Office of Inspector General (OIG) described the anatomy of distance education fraud rings, and it recommended a number of steps the Department should take to mitigate the risk of fraudulent activity.[106] Most of the ways identified by the OIG report to pinpoint potential fraud – such as identifying common street addresses, IP addresses, or web server logs – can and should be implemented administratively by the Department, which has data on all FAFSA applicants and federal aid recipients nationwide. Focusing these efforts at the federal level maximizes student privacy and minimizes institutional burden. Having robust federal administrative policies and procedures to hunt for fraud and properly identify high-risk applicants will help colleges make more efficient use of their resources. For instance, the Department should immediately start flagging for colleges potential fraud ring participants who repeatedly enroll at and withdraw from school after school.

- Consider students' total enrollment history in determining aid eligibility in certain circumstances. Existing SAP standards are designed to ensure that students make ongoing progress towards an appropriate academic or vocational goal while receiving aid. They were recently strengthened to standardize terms and statuses across colleges and ensure college policies are not looser than federal law allows. We affirm the importance of these standards and propose requiring colleges to consider students' total enrollment history in determining academic progress when fraud is suspected. For students flagged by the Department (see above) as having an application and/or aid history suggestive of fraud, colleges should collect information about prior enrollment history and include courses attempted at other colleges in SAP calculations. Colleges would have the authority to ignore prior coursework in certain circumstances, using professional judgment if a student's questionable application and/or aid history has a reasonable explanation. Students would retain the ability to appeal if their situation has changed in ways that make their future academic potential more promising than their prior academic history.

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[106] U.S. Department of Education, Office of Inspector General. 2011. *Investigative Program Advisory Report: Distance Education Fraud Rings.* http://www2.ed.gov/about/offices/list/oig/invtreports/l42l0001.pdf.

Section 3: College Eligibility and Accountability

To ensure that available federal aid dollars are spent wisely, we propose more closely tying colleges' eligibility to the risk to students in enrolling and the risk to taxpayers in investing, with rewards for colleges where risks are low. While students are and should be held accountable for the effort needed to earn a credential, colleges must be held accountable for delivering quality education to their students as a whole. In other words, when one student fails to graduate with a worthwhile degree, or graduates with insurmountable debt, it may be the fault of the student. When many or most students at a college meet the same fate, however, the school should bear some or most of the responsibility.

In summary, our recommendations are to:

- Sanction schools based on their Student Default Risk Index (SDRI) rather than their Cohort Default Rate (CDR).
- Require risk-sharing for colleges on the margins of Title IV eligibility that receive a majority of revenue from federal aid.
- Reward colleges with very low SDRIs with additional flexible funding based on their low-income student enrollment.
- Provide greater flexibility to innovate to schools with strong track records.
- Improve oversight and other accountability measures to better protect students.

Sanction schools based on their Student Default Risk Index (SDRI) rather than their Cohort Default Rate (CDR).

The federal government uses "cohort default rates," or CDRs, to assess colleges' eligibility for federal student aid funding from the U.S. Department of Education (Title IV funding). CDRs measure the share of a school's borrowers who default (i.e., make no payment for at least nine months) within the first few years of repayment. Colleges with CDRs above certain thresholds may face sanctions that end their eligibility for federal aid.

While CDRs provide useful information on how likely student loan borrowers from individual colleges are to default within a given timeframe, they are, by themselves, insufficient to inform consumers or policymakers about how *students* – both borrowers and non-borrowers – fare. That is because they exclude non-borrowers. Without knowing how many students borrowed loans in the first place, the share of them who defaulted is less meaningful.

Current law already acknowledges that colleges' borrowing rates are important context for CDRs. Colleges where relatively few students borrow, but that have relatively high CDRs, can appeal a potential loss of aid eligibility based on their "participation rate index" (PRI), a measure that combines colleges' default rates and borrowing rates. The PRI recognizes that CDRs may not be representative indicators of institutional quality at colleges where they reflect the outcomes of a small share of students.

Our proposal furthers this concept of the PRI by applying it to all colleges in the form of a "Student Default Risk Index" (SDRI) that would replace the CDR in assessing a college's eligibility for Title IV funding.[105] The SDRI is the three-year CDR multiplied by the school's borrowing rate. By incorporating the share of students who borrow loans into the measure, the SDRI more accurately conveys a student's risk of default at a given school.

For example, consider two schools with CDRs of 20 percent. At the first school, 90 percent of students borrow, so roughly 18 out of every 100 enrolled students end up in default on student loans shortly after entering repayment. At the second school, only five percent of students borrow, so only one out of 100 students end up in default within the same time period. The CDRs are the same, but the extent of the schools' default problems is quite different. The SDRI captures the risk to students and the extent of a school's default problem in one number, rather than requiring an examination of both the school's borrowing rate and default rate to assess the risk.

The SDRI Calculation				
	CDR	Borrowing Rate	Students' Risk of Default	SDRI
College 1	20%	90%	18%	18
College 2	20%	5%	1%	1

Similar to the current CDRs, schools with SDRIs above a specified threshold would no longer be eligible for Title IV aid.[106] The appropriate cutoff threshold needs careful consideration. For reference, the California legislature has twice considered using the SDRI for the purpose of determining institutional eligibility for state Cal Grants. In 2011, the proposed cutoff was 7.5 in any single year, using two-year CDRs.[107] In 2012, the proposed cutoff was 15.0 in any single year, using three-year CDRs.[108]

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[105] Other criteria for eligibility, including the 90-10 rule, would remain intact but modified as described in this section.

[106] Importantly, this would eliminate the need for colleges with low borrowing rates to appeal losses of eligibility using the PRI, as their borrowing rate would already be taken into account.

[107] Asimov, Nanette. March 9, 2011. *San Francisco Chronicle*. "DeVry, Heald Among Those Facing Cal Grant Cuts." http://www.sfgate.com/default/article/DeVry-Heald-among-those-facing-Cal-Grant-cuts-2389459.php.

[108] California Assembly Bill No. 1637 (2011-12 reg. session). http://bit.ly/VX2yfY.

How SDRIs Would Work

Currently, colleges generally lose all eligibility for Title IV aid if, over three consecutive years, 30 percent of their borrowers default on their student loans (CDR = 30%) within the first three years of repayment. Because they account for the share of students borrowing at a college, which cannot exceed 100 percent, SDRI scores are virtually always more lenient than CDRs of the same number. To illustrate, an SDRI cutoff of 30 is only equal to a CDR of 30 percent at schools where *every* undergraduate student borrows (30 times 100% equals 30), and at a college where 90 percent of students borrow, an SDRI cutoff of 30 would be equivalent to a CDR cutoff of 33.3 percent.

Determining the appropriate SDRI cutoffs for these categories will require careful consideration. However, to strengthen institutional accountability for colleges, the SDRI eligibility cutoff must be lower than 30. For discussion, we have provided some comparisons below.

Comparison of CDR and SDRI Thresholds

	Current CDR Thresholds: ≥ 30% CDR for three consecutive years, or >40% for any single year	Sample SDRI Threshold: SDRI ≥ 25
College A **CDR = 43%** **Borrowing rate = 49%**	Above thresholds, may lose eligibility	SDRI = 21, will not lose eligibility
College B **CDR = 29%** **Borrowing rate = 92%**	Below thresholds, will not lose eligibility	SDRI = 27, may lose eligibility

Student Defaults and Student Demographics

Some have suggested that colleges should not all be held to the same default standards, arguing that colleges that enroll more low-income students should be held to weaker standards than those who enroll high-income students. While student demographics play a role, the evidence is clear that demographics are by no means the sole explanation for default rates. Schools play an important role, and we should neither have lower standards for some students nor expect the least from schools that receive the most subsidy. Low-income and minority students should not be left to expect fewer jobs, lower salaries, and higher debts.

- A study commissioned by the main for-profit college trade association found that even after accounting for differences in student demographics, students attending for-profit colleges are at least twice as likely to default as students at other types of colleges.*

- Lenders report that the school attended affects a student's chance of default. In its private student loan business, Sallie Mae expects to see a 30 percent difference in default rates for a borrower with a FICO score greater than 700, "depending on the school that borrower attends."**

- A 2010 Education Sector report also documents the role schools can play in lowering default rates: "[T]he experience of the Texas HBCUs, along with a new statistical analysis of cohort default rates, suggests that dangerously high default rates for institutions that serve at-risk students are not inevitable.... Their [the Texas HBCUs'] success is not only applicable to other similar institutions, but to all schools that serve those students most at risk for default and who are committed to helping them."***

* Charles River Associates for the Career College Association. 2010. *Report on Gainful Employment.* http://1.usa.gov/hleokn.

** *Student Lending Analytics Blog.* February 12 2010. "Highlights of Sallie Mae Investor Meeting at Credit Suisse Conference." http://bit.ly/TfFANk.

*** Education Sector. 2010. *Lowering Student Loan Default Rates: What One Consortium of Historically Black Institutions Did to Succeed.* http://www.educationsector.org/usr_doc/Default_Rates_HBCU.pdf.

Require risk-sharing for colleges on the margins of Title IV eligibility that receive a majority of revenue from federal aid.

To further increase institutional accountability, as well as protect and target taxpayer investment, we also propose requiring that some colleges share students' and taxpayers' financial risk. Our proposal would apply to colleges that receive more than half of their annual revenue from federal aid (including Title IV as well as U.S. Department of Defense and Veterans Affairs benefits) and have SDRIs that are relatively high but fall below the eligibility cutoff. Currently, eligibility for federal aid is all or nothing, with no form of risk-sharing in place.

Affected colleges would be required to pay a risk-sharing fee equal to a percentage of either their annual loan volume or total amount of federal student aid received that year. The fees would go into an account managed and operated by the U.S. Department of Education (the Department) and used to fund the following: loan discharges because of school closures, false certification, or other fraud; improvements in loan counseling; loan default reduction efforts; and/or Pell Grants. Similar to insurance programs, higher risk colleges with high loan volumes and high SDRIs would pay more into the pool, with the percentages of loan volume paid increasing as colleges' SDRI increases. Also similar to insurance programs, the money a school pays into the account would not be restricted to assisting students from that school.

For instance, using example thresholds provided on page 38 (provided for illustration purposes only), and assuming fees of up to 10 percent of the total loan volume at affected colleges, we estimate that this proposal would generate at least $440 million in a single year for the purposes described above. Increasing the maximum percentage fee to 20 percent would generate double that amount, or at least $880 million.[illegible]

This concept of risk-sharing and graduated institutional eligibility could also be implemented using student loan repayment rates or other measures of risk. If some schools continue to be permitted to manipulate and artificially lower their CDRs, as discussed below, then alternative measures of students' ability to repay their loans should be considered. Additionally, the SDRI and/or repayment rate thresholds would need to be adjusted if enrollment in income-based repayment plans increases significantly, because that would lower the number of students

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[illegible] Calculations by TICAS using data from the U.S. Department of Education: FY09 three-year CDRs, 2010-11 undergraduate borrowing rates, 2010-11 Stafford Loan volume, and 2010-11 proprietary school 90-10 revenue percentages. Colleges with no students entering repayment in the FY09 cohort, those that did not disburse Stafford Loans in 2010-11, and those with no undergraduates enrolled were excluded from the estimates. Lacking comprehensive data on which public and nonprofit colleges receive more than half of their revenue from Title IV aid, our minimum estimate includes only risk-sharing contributions from for-profit colleges. Under this estimate, colleges' share of loan volume needed for risk-sharing would be equal to the SDRI (rounded down to the nearest integer) minus 14, expressed as a percentage, for colleges with SDRIs of at least 15 but less than 25. For example, the risk-sharing fee would be one percent of loan volume for a college with an SDRI of 15.5 and 10 percent of loan volume for a college with an SDRI of 24.5. At these contribution levels and based on the most recent data available, we estimate that for-profit colleges with SDRIs at or above 15 and below 25 would contribute $455 million. We decreased this figure by three percent to recognize that approximately 3 percent of for-profit Title IV aid goes to colleges at which Title IV revenue comprises less than a majority of funding and would therefore not be subject to required risk-sharing.

entering default and reduce CDRs for reasons unassociated with the colleges. Steps would also need to be taken to prevent schools from discouraging students from borrowing for the sole purpose of lowering the school's SDRI rather than it being in the student's best interest.

Reward colleges with very low SDRIs with additional flexible funding based on their low-income student enrollment.

We also propose using the SDRI to allocate additional grant aid to colleges that keep students' likelihood of default very low. Under this proposal, colleges with SDRIs below a designated threshold would receive a certain amount of funding based on the amount of Pell Grant dollars disbursed to their students. By basing the additional funding on Pell Grant dollars disbursed, colleges would be encouraged to enroll low-income students, help them apply for aid, and support them in enrolling full time. Colleges would have flexibility in how they award the additional funds, similar to current campus-based aid programs through which colleges receive federal funds to disburse as they deem appropriate to meet their students' financial need. Should the enhanced Pell Grant described in Section 4 be fully funded, colleges would not be required to spend these funds on student financial aid but would have the flexibility to use these funds however they see fit, including on student services or financial aid administration.

Only colleges offering federal loans would be eligible for this supplemental funding. More than one million community college students nationally are enrolled at colleges that have chosen to restrict their students' access to federal aid by not offering federal student loans.[110] This additional funding would serve as an incentive for colleges to offer federal loans, and colleges' continued choice not to offer loans would be understood as a statement that neither the college nor its students need additional funding.

Based on SDRIs using three-year CDRs for fiscal year 2009, roughly $1 billion in supplemental grant funds would provide colleges with SDRIs below two with roughly $750 per maximum Pell Grant award. Rewarding colleges with SDRIs below five at the same rate would cost roughly $2.2 billion.[111] This new program could be created in addition to or instead of the Federal Supplemental Educational Opportunity Grant (SEOG), through which about $1 billion per year is awarded.[112] Our proposal would help shift campus-based aid resources to colleges that enroll low-income students and serve them well, a shift in direction that should occur for all federal campus-based aid.[113] Currently, campus-based aid resources are more heavily concentrated at

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[110] TICAS. 2011. *Still Denied: How Community Colleges Shortchange Students by Not Offering Federal Loans.* http://projectonstudentdebt.org/files/pub/still_denied.pdf.

[111] Calculations by TICAS using data from the U.S. Department of Education: FY09 three-year CDRs, 2010-11 undergraduate borrowing rates, and 2010-11 Pell Grant volume. Colleges with no students entering repayment in the FY09 cohort and those that did not disburse Stafford Loans in 2010-11 were excluded from the estimates. For each college with an SDRI below two, we divided their total Pell disbursements by the size of the maximum 2010-11 Pell Grant ($5,550) and then multiplied by $750, for a total of $920 million.

[112] For more information about SEOG, see http://www2.ed.gov/programs/fseog/index.html.

[113] For more information about reallocating campus-based aid, see http://www.ticas.org/files/pub/POTUS_Proposal_Jan_2012_STA.pdf.

schools based on unrelated factors, such as the length of time that the school has been in the program.

Provide greater flexibility to innovate to schools with strong track records.

In addition to holding poorly performing schools more accountable, federal policies should provide greater flexibility and incentives for innovation to colleges with a record of graduating low- and moderate-income students with meaningful credentials and without burdensome debt. While a school's own policies, practices, and internal systems may be a greater obstacle to innovation, there is no question that federal student aid policies can be a barrier to finding new ways to provide greater access to a quality education at a lower cost.

With few exceptions, federal policies currently treat all colleges alike, regardless of their record of serving students well. This means the policies in place to protect taxpayers and students attending relatively new for-profit colleges such as the Sawyer School or American Career Institute, whose sudden closing of campuses left thousands of students displaced and stranded, usually also apply to public colleges like the University of California at Riverside or SUNY Stony Brook, which have been around for more than 50 years and without disruption successfully graduate low-income and minority students with manageable debt.[114] There is precedent for providing greater flexibility to colleges based on their track records. For example, under current law, schools with lower default rates are given greater flexibility in the disbursement of student loans.[115] In addition, nonprofit and for-profit colleges with strong "financial responsibility scores" are subject to less oversight and monitoring than schools with lower financial responsibility scores.[116] However, these examples are exceptions to the general rule of a one-size-fits-all approach to regulation and oversight, which tends to overregulate the best colleges and underregulate the worst.

To foster innovation and target the strongest oversight where it is most needed, more policies should take into account how well a college serves students in terms of access, affordability, and success (completion with a quality degree without burdensome debt). This is why TICAS and three student organizations urged the Department to review only new career education programs offered by institutions with poor track records (as measured by their program repayment rates and debt-to-income ratios), instead of scrutinizing such programs at all

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[114] Di Meglio, Francesca. January 9, 2013. "Investigators Probe Shuttered For-Profit Colleges." *Bloomberg Businessweek*. http://www.businessweek.com/articles/2013-01-09/investigators-probe-shuttered-for-profit-colleges#r=hpt-ls. Halperin, David. January 14, 2013. "For-Profit College Shuts Down, Leaving Students Out in the Cold." *Huffington Post Blog*. http://www.huffingtonpost.com/davidhalperin/for-profit-college-shuts_b_2474087.html.

[115] For example, schools with a CDR of less than five percent are eligible to make single and nondelayed disbursements of loans for attendance in a study-abroad program. Schools with default rates of less than 15 percent are not required to delay the delivery or disbursement of loans for 30 days for first-time, first-year undergraduate borrowers. For more information, see http://ifap.ed.gov/DefaultManagement/finalcdrg.html.

[116] For more information on the relationship of financial responsibility scores to levels of oversight, see http://studentaid.ed.gov/about/data-center/school/composite-scores.

institutions.[117] Limiting new program reviews to institutions with poor records provides a strong incentive for institutions to ensure their programs are of high quality, and also reduces the administrative burden for institutions that have already demonstrated a strong record of preparing students for gainful employment.

Example of SDRI Thresholds for School Sanctions, Risk-Sharing, and Rewards

SDRI	Treatment
≥ 25	Ineligible for federal aid
< 25 and ≥ 15	Risk-sharing rules apply to colleges receiving a majority of their revenue from federal taxpayers
<2	Eligible for additional federal funding per Pell Grant dollars disbursed and/or greater flexibility to innovate

It is important to note that any student outcome measure used to assess an institution must be carefully chosen to avoid unintended consequences, such as rewarding schools for graduating students from costly but worthless short-term certificate programs or for only enrolling the lowest risk students. However, this should not deter policymakers from looking for opportunities to design policies that effectively reward institutions for positive outcomes in addition to holding them accountable for troubling ones.

Improve oversight and other accountability measures to better protect students.

Current institutional eligibility rules are much too weak. Whether the current CDR measure and standards continue to be used to sanction schools or are replaced with the more robust SDRI, there are a number of additional policy changes that must be made to ensure the integrity of the federal student aid programs.

- **Investigate schools that manipulate their CDRs in an attempt to avoid oversight.** The Department must do more to ensure that colleges do not evade sanctions through CDR manipulation. Whether used as a standalone measure or as part of an SDRI calculation, the measure of student loan default must be meaningful. As written in law, the measurement includes only borrowers who fail to make any payment for an entire year in a two- to three-year period. In general, colleges do not fully lose eligibility for

[117] September 9, 2010 comments submitted by TICAS and three national student groups (the United States Students Association, U.S. Public Interest Research Groups, and Campus Progress) on proposed regulations to define gainful employment at http://ticas.org/pub_view.php?idx=661. More than 20 student, consumer, education, and civil-rights organizations endorsed a similar approach in November 14, 2011 comments on proposed rules regarding new gainful employment programs at http://ticas.org/files/pub/GE_New_program_approval_commentsFINAL_Nov14.pdf.

aid until they have CDRs at or above 30 percent for three consecutive years or above 40 percent for one year. This is a very weak standard, which has been further weakened by college practices that manipulate their default rates. For example, a number of colleges have admitted to masking serious problems by having would-be defaulters burn through time-limited repayment protections (e.g., forbearance), or by consolidating campuses to mask very high default rates at certain locations. The Department could address these issues by investigating instances of repeat forbearances and monitoring colleges' CDRs as both consolidated and separate entities for a specified period of time.[118]

- **Make the process of administering CDR sanction appeals automatic for colleges with low borrowing rates.**
  Currently, many colleges with low borrowing rates that could benefit from the PRI appeal (described above) do not know about it, understand how it works, or know how to apply for it.[119] If sanctions based on CDRs are not replaced by sanctions based on SDRIs, the Department should administer these appeals automatically with minimal new data collection. The Department should also be providing this type of guidance proactively.

- **Tell schools what is permissible under a policy, not just what is impermissible.**
  It can be challenging to explain what colleges may do as well as what they may not do, but it is essential for the Department to be more detailed to prevent colleges from incorrectly believing they do not have authority to innovate. Even without changes in federal policy, the Department could promote innovation simply by better informing colleges about what they may do under current regulations. For instance, some colleges have expressed concern that current policies do not permit them to deny students access to federal loans even when the school believes it is not in the student's best interest to borrow more. TICAS, in collaboration with the California Community College Student Financial Aid Administrators Association (CCCSFAAA), recently issued a report (*Making Loans Work: How Community Colleges Support Responsible Student Borrowing*) documenting how colleges can and do counsel students on borrowing, including denying students loans on a case-by-case basis when warranted.[120]

- **Strengthen the federal "90-10" rule.**
  The "90-10" rule prohibits for-profit colleges from receiving more than 90 percent of their revenue from federal student aid. Since being enacted with strong bipartisan support in 1992, the rule has been weakened substantially and includes loopholes that allow colleges to count GI Bill funds and U.S. Department of Defense Tuition Assistance as private rather than federal dollars. Bills have been introduced in both the Senate and

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[118] For more information on ways for-profit college companies may be manipulating their CDRs and steps the Department should immediately take to ensure full compliance with federal law and protect taxpayers from subsidizing schools with CDRs above the permitted thresholds, see TICAS' August 2012 memo at http://ticas.org/pub_view.php?idx=856.

[119] For more information about why the current appeals process is problematic, see TICAS. 2011. *Still Denied: How Community Colleges Shortchange Students by Not Offering Federal Loans.* http://projectonstudentdebt.org/files/pub/still_denied.pdf.

[120] CCCSFAAA and TICAS. 2012. *Making Loans Work: How Community Colleges Support Responsible Student Borrowing.* http://ticas.org/files/pub/Making_Loans_Work.pdf.

House to close this loophole and strengthen the 90-10 rule to remove the existing incentive to exploit veterans, service members, and their families.[121]

- **Strengthen and enforce the "gainful employment" rule.**
  Federal law has long required career education programs at all types of colleges to prepare students for gainful employment, but the lack of a definition of "gainful employment" has prevented the law from being enforced. The Department's recent efforts to define the term and enforce the law are currently tied up in the courts, but the Federal District Court both affirmed the Department's authority to enforce the law and the need to do so.[122] Swift action must be taken to ensure that both students and taxpayers are protected from unscrupulous schools that seek to swindle them and routinely saddle students with debts they cannot repay.[123] Schools also need to be held accountable for providing the disclosures required for gainful employment programs so that students can make informed decisions about where to attend.

- **Bar schools from using federal student aid dollars for advertising, marketing, and recruiting.**
  A two-year investigation by the Senate Health, Education, Labor, and Pensions (HELP) Committee revealed that the majority of students at 30 for-profit college companies left without a degree but almost all their students had debt. The 30 for-profit college companies examined spent on average more than twice as much on marketing, recruiting, and profits (42%) as on instruction (17%).[124] In Fiscal Year 2009, these companies spent $4.2 billion, or 23 percent of their budgets, on advertising, marketing, and recruitment. Senate and House legislation to prohibit any type of college from using federal taxpayer dollars for advertising and recruiting has been endorsed by a diverse range of organizations representing veterans and advocates for students, consumers, civil rights, and education.[125]

- **Impose intermediate sanctions when appropriate to protect students and taxpayers.**
  Even when accreditors or the Department find serious problems at a college, they rarely revoke the school's accreditation or eligibility for federal student aid because it can be tantamount to closing the school. In the meantime, students continue to enroll unaware of the problems and taxpayers continue to subsidize their enrollment. Even when the problems are so severe that the schools are required to notify their board and/or investors of the problem, students are often left in the dark. As the Association of Public and Land-grant Universities recently recommended, the Department should, when

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[121] For more information about the 90-10 Rule, why it needs to be strengthened, and the veterans' and military service groups and leaders that support a stronger 90-10 Rule, see http://bit.ly/WDpimp.

[122] For more information, see http://views.ticas.org/?p=884.

[123] For more information about the broad coalition in support of greater accountability for career education programs, see http://www.protectstudentsandtaxpayers.org/.

[124] Senate HELP Committee. 2012. *For-Profit Higher Education: The Failure to Safeguard the Federal Investment and Ensure Student Success.* http://www.help.senate.gov/imo/media/for_profit_report/Contents.pdf.

[125] For more information about the Protecting Financial Aid for Students and Taxpayers Act, see http://www.hagan.senate.gov/?p=press_release&id=1770 and http://thomas.loc.gov/cgi-bin/query/z?c113:H.R.340:

appropriate, exercise its authority to impose intermediate sanctions on schools, such as limiting their eligibility for Title IV funding and requiring that students are notified of the problems.[126] The sanctions could be lifted once the school addresses the problem.

Greater use of intermediate sanctions would both better protect students and taxpayers and better deter problems in the first place.

Section 4: Grant Aid

The federal Pell Grant program is the largest single source of need-based grant aid in the country. It helps more than nine million college students nationally cover college costs.[127] These students of all ages are enrolled in undergraduate programs ranging from short-term certificates to bachelor's degrees.

The Pell Grant has evolved over time, with statutory changes that have expanded or contracted eligibility, with a range of rationales. The basic premise, however, has remained the same: to help ensure access to college for students with the willingness and dedication to earn a college credential but with scarce financial resources.

Through the recent economic downturn, the Pell Grant program has responded as a counter-cyclical program should: by expanding in times of greater need to help more people to and through college. When more people had less income and all the reason to seek postsecondary education, the Pell Grant program was able to respond immediately to provide critical support. Thus, while the increased costs have attracted scrutiny, they are neither surprising nor undesirable. Creating a better-educated workforce is the surest path to a strong economy. The Pell Grant program helps to ensure that our lowest income students have the opportunity to be part of that workforce, which is crucial to the nation's future as well as their own.

Unfortunately, low-income students are still less likely to go to college than their equally prepared, higher income peers. Those who do attend college are less likely to persist or graduate. These achievement gaps by income have widened over recent decades, not narrowed. As researchers Bailey and Dynarski found, "Even among those who had the same measured

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[126] Association of Public and Land-grant Universities. 2013. *Federal Student Aid: Access and Completion.* http://www.aplu.org/page.aspx?pid=2616. P.7.

[127] For other key facts about the Pell Grant program, see http://ticas.org/files/pub//Overall_Pell_one-pager_11-26-12.pdf.

cognitive skills as teenagers, inequality in college entry and completion across income groups is greater today than it was two decades ago."[128]

Over this same period, college costs have grown much faster than families' ability to pay, and grant aid has not kept pace. Today's maximum Pell Grant ($5,550 in 2012-13) covers the lowest share of college costs since the start of the program, covering only 31 percent of college costs compared to more than twice that in the late 1970s (between 69% and 84%).[129] Despite a small increase for 2013-14, next year's maximum grant of $5,635 will cover only 30 percent of costs.

To increase the effectiveness of the federal Pell Grant, we make the following recommendations:

- Double the maximum Pell Grant to close income gaps in access and attainment.
- Consider maintenance of effort provisions to discourage disinvestment.
- Make Pell Grants a mandatory program.
- Better align Pell Grant program parameters and policies with goals.

Double the maximum Pell Grant to close income gaps in access and attainment.

We propose setting the maximum Pell Grant at an amount designed to overcome income gaps in college access and success. Specifically, evidence suggests that the Pell Grant needs to be roughly doubled.

Exactly how to determine the appropriate maximum Pell Grant award will require careful consideration and analysis of available literature. While the presence of income gaps has been well documented, many studies do not take other critical factors, like academic preparation or college selectivity, into account. Similarly, many researchers have found links between grant aid and students' likelihood of enrollment, persistence, and completion, but much of it is focused beyond the Pell Grant program or even need-based grant aid specifically.

Still, the evidence that does exist shows the same general trends: that low-income students are much less likely to enroll or complete than higher income students, and that increased, targeted grant aid increases their chances of enrolling and completing. Providing sufficient grant aid can help to close gaps in college enrollment and completion. Here are examples of how the size of a sufficient grant might be determined (see footnotes for study citations):[130]

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[128] Bailey, Martha and Susan Dynarski. 2011. *Gains and Gaps: Changing Inequality in U.S. College Entry and Completion.* National Bureau of Economic Research. Working Paper 17633, http://www.nber.org/papers/w17633.pdf. P. 12.

[129] College costs defined here as average total tuition, fees, room, and board costs at public four-year colleges. Calculations by TICAS on data from the College Board, *Trends in College Pricing 2012*, Table 2, http://bit.ly/14Ofvbv, and U.S. Department of Education data on the maximum Pell Grant.

[130] By using available research to quantify both income gaps and financial aid effects, we can estimate how much financial aid it would take to close the gaps. For instance, in the first row, if $1,000 of financial aid increases the probability of enrollment by

Evidence of Gap to Close	Evidence of Financial Aid Effect	Resulting Maximum Pell for 2013-14
Enrollment in postsecondary education by age 18-22: 30% poverty, 59% non-poverty, **29 percentage point gap.**[131]	A $1,000 increase in grant aid increased the probability of enrollment by **4.0 percentage points**.[132]	$12,200
Four-year college enrollment of high school graduates who completed at least trigonometry: 73% low-income, 90% high-income, **17 percentage point gap.**[133]	$1,000 in need-based state grant aid increased the likelihood of immediate enrollment in a public four-year college by **2.5 percentage points**.[134]	$10,800
B.A. attainment of students who completed at least trigonometry in high school and started at a four-year college: 69% low-income, 88% high-income, **19 percentage point gap.**[135]	$1,000 in need-based state grant aid increased the likelihood of earning a B.A. within six years by **3.5 percentage points**.[136]	$9,400
Among students whose highest high school math is Algebra 2, completion rates at moderately selective four-year colleges: 52% lowest income quartile, 73% highest income quartile, **21 percentage point gap.**[137]	$1,000 in need-based state grant aid increased the likelihood of earning a B.A. within six years by **3.5 percentage points**.[138]	$11,200

4.0 percentage points, then it would take $7,250 in additional aid to close a 29 percentage point gap. We then inflate the value of the maximum Pell Grant available in the base year of the research documenting the enrollment/completion gap (in this example, a maximum grant of $3,750 in 2001-02), and add the Pell supplement needed to close the gap. We add the supplemental funding in current dollars (as opposed to the base year grant) to derive solid yet conservative estimates and to reflect the consistent finding that $1,000 of additional grant aid, in a variety of years, has demonstrable effects.

[131] Pathways to Postsecondary Success. 2012. *Low-Income Young Adults Continue to Face Barriers to College Entry and Degree Completion.* http://pathways.gseis.ucla.edu/publications/201201_ashtianifelcianoRB_online.pdf.

[132] Dynarski, Susan. 1999. *Does Aid Matter? Measuring the Effects of Student Aid on College Attendance and Completion.* National Bureau of Economic Research. Working Paper 7422. http://www.nber.org/papers/w7422.

[133] Advisory Committee on Student Financial Assistance (ACSFA). 2006. *Mortgaging Our Future: How Financial Barriers to College Undercut America's Global Competitiveness.* http://www2.ed.gov/about/bdscomm/list/acsfa/mof.pdf.

[134] Castleman, Benjamin and Bridget Terry Long. 2012. *Looking Beyond Enrollment: The Causal Effect of Need-Based Grants on College Access, Persistence, and Graduation.* http://bit.ly/Y0FUCW.

[135] ACSFA 2006.

[136] Castleman and Long 2012.

[137] TICAS calculations based on data from the U.S. Department of Education, 2003-04 Beginning Postsecondary Students Longitudinal Study, Second Follow-Up (BPS:04/09).

[138] Castleman and Long 2012.

These imprecise estimates range from $9,400 to $12,200 and each would represent a significant increase in the maximum Pell Grant, to roughly double on average the scheduled 2013-14 maximum grant of $5,635. However, it is worth noting that even a doubled maximum Pell Grant of $11,270 would cover a smaller share of college costs (60%) than the maximum grant covered in the late 1970s.[139]

Once an appropriate maximum Pell Grant amount is determined, it should be indexed to increase over time and could be phased in over a period of several years to manage the upfront cost. For students whose Pell eligibility exceeds their total college costs, their Pell Grant would be capped at their cost of attendance. To retain the highly targeted nature of Pell Grants, larger maximum awards could be provided by giving additional funding to students who meet current Pell eligibility criteria. This would have the effect of providing larger grants to Pell recipients without greatly increasing the number of students who are eligible. This is in contrast to the current formula, through which increases in the maximum award automatically broaden the range of students eligible for grants.

Our proposal to significantly increase Pell Grants to restore their purchasing power and better target funds to the students who need them most will require billions of dollars more. This investment is sound and supported by the evidence. It is also necessary if we are serious about making college affordable for all students willing to study hard, so that we can maintain and build an internationally competitive workforce. See Appendix for more details on ways to cover this cost.

Consider maintenance of effort provisions to discourage disinvestment.

States and institutions have a critical role to play in supporting student access and success. Unfortunately, as discussed in Section 1, states have been retreating from their commitment to higher education support. Therefore, with the significant increase in federal investment that we recommend, Congress should consider "maintenance of effort" (MOE) provisions to ensure that new federal dollars are leveraged efficiently and do not displace state and institutional dollars. Additionally, Congress should consider language to ensure that as new Pell Grant funding is ratcheted up over time, that those dollars supplement, not supplant, state- and institution-based aid.

Make Pell Grants a mandatory program.

The Pell Grant is unique among all federal programs. It functions like an entitlement, but is largely funded as a "discretionary" program, subject to annual appropriations by Congress.[140] In

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[139] College costs defined here as average total tuition, fees, room, and board costs at public four-year colleges. Calculations by TICAS on data from the College Board, *Trends in College Pricing 2012*, Table 2, and U.S. Department of Education data on the maximum Pell Grant.

[140] For more on how Pell Grants are funded, see http://febp.newamerica.net/background-analysis/federal-pell-grant-budget-scoring-rule.

years when the appropriations provided are insufficient to cover actual program costs, funding gaps are created, and when appropriations exceed actual costs, surpluses are created. Periodic funding gaps and surpluses are inevitable given how it is currently funded. For example, after several years of funding gaps, during which the program was cut in multiple ways, the program is now projected to have a $9.2 billion surplus in fiscal year 2013 and a $4.5 billion surplus in fiscal year 2014.[111] As long as its funding is subject to annual appropriations, no amount of cutting or increased funding can prevent Pell Grant funding gaps and assure it sufficient annual funding. To best enable access and success, Pell Grants need to be funded as a mandatory program, not subject to annual appropriations.

Because Pell Grants operate like a mandatory program, every qualified student receives a Pell Grant, regardless of how many other students are eligible in a given year. The mandatory aspect of the program is what makes it possible to guarantee every qualified student a Pell Grant and for Pell Grants to be available when sudden changes in the local or national economy lead to an influx of students seeking more education and training. When the economy sank in 2008 and millions of Americans lost their jobs, the Pell Grant program responded immediately, with its funding peaking in 2011. For the same reasons, both farm subsidies and the school lunch program are mandatory programs, enabling them to respond immediately to the needs of farmers and children without having to wait for elected officials in Washington, D.C. to act.

However, despite operating like a mandatory program, Pell Grants are still largely funded as a discretionary program. As a result, Pell Grants and students are subject to annual budget appropriations and negotiations, with policy discussions centered around what costs the most, rather than what matters the most. A glaring example of this is when Pell Grants recently had a funding gap, Congress chose to cut grants for more than 100,000 recipients – transfer students and those near graduation in particular – by implementing a retroactive, six-year time limit on Pell receipt. (See Section 1 for more information on this policy change.)

Low-income students and their college plans must not hang in the balance from year to year. Such uncertainty undermines both access and success for students with no financial cushion to fall back on if their grants unpredictably shrink or disappear. Making all Pell Grant funding mandatory would match the purpose and countercyclical nature of the program.

Transitioning the Pell Grant program from a discretionary program to a mandatory one can be difficult under budgeting rules, but the Budget Control Act passed in 2011 provides an avenue for this transition to occur more easily. Pell Grant spending falls under a discretionary spending cap, and the cap could be reduced by the size of the Pell Grant program – creating savings – to allow it to be recreated as a mandatory program.

[111] Assumes Congress maintains the FY12 discretionary appropriation for Pell Grants in FY13 and FY14. Calculations by the Center on Budget and Policy Priorities on data from the Congressional Budget Office (CBO), February 2013 baseline projections for the Pell Grant program, http://cbo.gov/sites/default/files/cbofiles/attachments/43912_PellGrants.pdf.

Better align Pell Grant program parameters and policies with goals.

- **Rename Pell Grants as Pell Scholarships.**
  This would better convey the academic expectation of all recipients. Focusing on the positive factors associated with Pell Grants (achievement) rather than the negative ones (poverty, need) may increase the meaning of and response to the awards.[142] No additional merit criteria for grant eligibility should be introduced pursuant to this change.

- **Limit to two the number of semesters that a student can be enrolled less than half time and receive a Pell Grant.**
  Studies have shown that less-than-half-time students are similar in many ways to students enrolled in more units, and students who enroll less than half time typically do so only rarely and in response to special circumstances.[143] Allowing limited Pell Grants for less-than-half-time attendance would encourage students to take more courses but provide a reasonable allowance for unforeseen circumstances that limit course-taking ability.

- **Set the lifetime limit for Pell at an amount designed to allow completion of a bachelor's degree.**
  The recent creation of a retroactive six-year time limit for Pell Grants was not only devastating for students (see Section 1 for more information on this policy change), but it was also inconsistent with other federal rules. Satisfactory academic progress (SAP) guidelines allow for aid eligibility up to 150 percent of the program length, and with full-time awards available with a 12-credit courseload, this would mean a standard (non-remedial) limit of 7.5 years. To be consistent with the SAP guidelines, the Pell Grant limit should be 7.5 years and should exclude up to one year of Pell Grants for remedial coursework.

- **Reinstate Pell Grant eligibility to recipients whose federal loans are discharged due to false certification or closed schools.**
  This change would ensure that these students' prior Pell Grant receipt does not keep them from pursuing further education.

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[142] Scott-Clayton, Judith. 2012. *Information Constraints and Financial Aid Policy.* National Bureau of Economic Research. Working Paper 17811. http://www.nber.org/papers/w17811.

[143] Washington Higher Education Coordinating Board. 2006. *Washington State Need Grant Less-than-Halftime Pilot Project.* http://www.wsac.wa.gov/sites/default/files/SNG-LTHFullreport-PDF.pdf. Illinois Student Assistance Commission. 2001. *Initiative to Aid Illinois Adult Learners.* http://www.isac.org/dotAsset/eadbf229-cd07-477d-bae7-269d64daab1a.pdf.

Section 5: Student Loans

The current federal student loan program is too complex, its benefits are poorly targeted, and its terms are too arbitrary. Much of the complexity is a holdover from when banks received subsidies to make Stafford Loans with terms set and guaranteed by the government. The resulting rules shielded banks – but not borrowers or taxpayers – from risk. Now that these federal loans are made directly and more cost-effectively by the U.S. Department of Education (the Department), the entire student loan system can and should be streamlined and improved.

From the myriad types and terms of different loans through to the repayment process, it can be hard to figure out how federal student loans work. Consider just the main source of undergraduate loans since July 2010: the Direct Stafford Loan program. There are "subsidized" and "unsubsidized" Stafford Loans, each with different interest rates, eligibility criteria, and treatment of interest during school and periods of deferment, with separate caps on how much a student can borrow each year and cumulatively. The vast majority (82%) of undergraduates with subsidized loans also have unsubsidized loans,[144] so some of their loans accrue interest while they are in school and some do not, and their loans may have different interest rates even when they took them out at the same time.

Subsidized loans currently provide students with valuable benefits, including a low fixed interest rate and no interest accrual while they are in school.[145] However, these benefits are not well targeted, as high-income students may qualify just because they attend a high-cost college, and most students with subsidized loans also have unsubsidized loans.

All Stafford Loans offer flexible repayment plans, as well as loan deferments and forbearances, yet more than one in eight student loan borrowers is defaulting within three years of entering repayment.[146] The consequences of defaulting on a federal loan can follow borrowers for the rest of their lives, ruining their credit, making it difficult to buy a car or rent an apartment, and limiting their job prospects. They may also face garnished wages, seized income tax refunds, and diminished Social Security checks.

Finally, the Stafford Loan interest rates are currently set by Congress, and are not tied in any way to the cost of lending. As a result, while interest rates on 10-year Treasury notes are currently two percent, the subsidized loan interest rate is scheduled to double this July from 3.4 percent to 6.8 percent. In today's unusually low interest-rate environment, the federal loan

[144] Calculations by TICAS on data for 2011-2012 from the College Board, *Trends in Student Aid 2012*, Table 6a. http://bit.ly/155ZtyV.

[145] For more information about both subsidized and unsubsidized Stafford Loans, see http://studentaid.ed.gov/types/loans/subsidized-unsubsidized.

[146] For the most recent federal loan cohort default rates at the time of publication, see http://1.usa.gov/OfVLKB.

program generates billions of dollars a year for the government, but when interest rates in the market rise, it could cost the government billions of dollars.

Reform is clearly and urgently needed. Our loan recommendations aim to better support access and success while containing costs and risks for both students and taxpayers. To achieve those goals, we propose simplifying the loan program, improving the targeting of benefits, containing debt burdens, and encouraging wise borrowing. Our recommendations include:

- Provide a single undergraduate student loan with no fees, a low in-school interest rate, and a fixed rate in repayment that is never too much higher than the rate on loans being offered to current students.
- Streamline and improve federal loan repayment options.
- Improve the timing, content, and effectiveness of student loan counseling.
- Better prevent student loan defaults.
- Reform the student loan collections process.
- Strengthen consumer protections for private student loan borrowers.

Provide one simple, affordable undergraduate loan program.

We propose replacing the current Stafford Loans with one simple, affordable undergraduate loan. Our recommended changes are designed to simplify the loan program, ensure that loans both appear and are affordable for borrowers, and better align the cost of the loan for the student with the costs for the government. There is no way to perfectly balance all three of these goals. However, what we propose is an important step forward on each front, focused on making federal student loans a more effective tool for ensuring access and supporting success while containing risk for both the student and the taxpayer. This undergraduate student loan program would have the following components.

- **One Loan.**
  Specifically, we recommend that there be one federal loan for undergraduate students, in place of the subsidized and unsubsidized Stafford Loans available today. A single loan will be much easier for borrowers to understand and keep track of, and for schools and the Department to administer. This loan – which we refer to in this paper as the One Loan – has an interest rate that is lower while the student is in school and higher by a set margin, but capped, when the borrower enters repayment. The interest rates are tied to the government's cost of borrowing and designed to offset the cost of the loan program, rather than being arbitrarily set by Congress. To help borrowers who go to school when interest rates are unusually high, One Loans have a built-in form of insurance that keeps their rates from ever being too much higher than the rate on loans being offered to current students.
- **Fixed interest rates and no fees.**
  One Loans have fixed interest rates and no fees. Fixed rates are important to provide

certainty, predictability and reassurance to students, many of whom have never borrowed before and may not fully understand the consequences of variable rates. The recent mortgage crisis demonstrated all too clearly that millions of Americans with mortgages did not understand the risks of variable rates, with terrible consequences for both them and our nation's economy. Fixed interest rates also further distinguish One Loans, which are a form of financial aid, from other financial products such as credit cards and private loans. Most private loans have variable, uncapped rates and require a cosigner.[147] The private loans that offer fixed rates will almost certainly have higher interest rates than One Loans for all borrowers except those who have, or whose cosigners have, pristine credit. At the height of the lending boom in 2007-08, a majority of private student loan borrowers had not taken out as much as they could have in federal loans first, underscoring the need to clearly distinguish federal student loans from private loans.[148]

The One Loan's fixed rate is tied to the government's cost of borrowing in the year the loan is disbursed. For instance, the interest rate on all loans disbursed in a given school year might be set based on the interest rate on the one-year Treasury bill or 10-year Treasury note at the final auction preceding June 1 of that year. Students who take out One Loans each year that they are in school may end up having loans with different interest rates, depending on the market conditions each year. However, all the other terms of their One Loans would be the same.

There is no reason for the new loan to have fees, which are a remnant from the bank-based guaranteed loan program and add unneeded complexity to the loan. The fixed interest rate will be set to cover the cost of One Loans without needing to add supplemental fees. How the fixed in-school and out-of-school rate for each loan will work is described immediately below.

- **Low in-school interest rate.**
  The in-school interest rate on One Loans is based on the government's actual cost of borrowing when the loans are made. The rate for new loans would take effect each year on July 1 and apply to all loans issued through June 30 of the following year. For instance, if it were tied to the 10-year Treasury note, the in-school rate on One Loans for the current school year would be less than two percent. The in-school rate applies while the borrower is enrolled at least half time and during a six-month grace period after they leave school, similar to the usual timing of the interest subsidy on subsidized Stafford Loans. Having a lower interest rate when students are in school is intended to encourage them to stay enrolled and complete their education, knowing that their interest rate will rise if they stop out or drop out. Lower in-school interest rates also help encourage the use of federal loans over private loans or other types of financing

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147 U.S. Consumer Financial Protection Bureau and U.S. Department of Education. 2012. *Private Student Loans: Report to the Senate Committee on Banking, Housing, and Urban Affairs, the Senate Committee on Health, Education, Labor, and Pensions, the House of Representatives Committee on Financial Services, and the House of Representatives Committee on Education and the Workforce.* http://files.consumerfinance.gov/f/201207_cfpb_Reports_Private-Student-Loans.pdf.

148 TICAS. 2011. *Private Loans: Facts and Trends.* http://projectonstudentdebt.org/files/pub/private_loan_facts_trends.pdf.

available to consumers with limited or no credit histories. Charging a low in-school rate, rather than charging no interest, while the student is enrolled is designed both to lower the cost of providing the loan and to discourage students from dragging out their time in school.

- **Higher, but capped, out-of-school rate.**
  The One Loan's out-of-school interest rate is set as the in-school rate when the loans were taken out, *plus* a fixed margin designed to cover the cost of the loan program, including the interest-rate insurance described below, loan forgiveness and discharge, and administrative costs. For example, imagine a One Loan with an in-school interest rate of three percent, based on the government's cost of borrowing that year. If, for illustration purposes only, the repayment rate were set at the in-school rate plus two percentage points, it would have an out-of-school interest rate of five percent. The out-of-school rate, while higher than the in-school rate, must be low enough to ensure that federal loans are – and look like – financial aid in contrast to other types of financing such as private loans.

  The out-of-school interest rate on One Loans will be subject to a universal cap, like Stafford Loan interest rates under current law and in the past. Currently the maximum Stafford Loan interest rate is 6.8 percent and the cap has as been set as high as 9.0 percent in the recent past.149 A universal cap helps protects consumers from extremely high rates in the economy and reinforces the differences between federal loans and commercial financial products. For example, if the universal cap were seven percent, the in-school interest rate were six percent, and the repayment rate set at the in-school rate plus two percentage points, the One Loan would have an out-of-school interest rate of seven percent, because the universal cap would keep the rate from rising above seven percent.

- **Interest-rate insurance.**
  The One Loan has an important new feature: a form of insurance that prevents interest rates from ever being too much higher than the rate on loans being offered to current students. This feature addresses the major disadvantage of fixed rates for borrowers, without requiring refinancing or consolidation. Borrowers with unsubsidized Stafford Loans today face this issue. While a 6.8 percent once seemed like a good deal, in the current low-interest rate environment, it is very high. To prevent borrowers from getting stuck with high fixed rates when market rates decline significantly, the interest rate on One Loans will reset to a lower fixed rate when interest rates in the economy drop substantially from when the loan was issued. For illustration purposes only, the interest rate insurance might prevent outstanding One Loans from having a rate that is more than two percentage points above the rate on loans being offered to current students. If a borrower had a One Loan with an out-of-school interest rate of 6.5 percent, and interest rates dropped so that the One Loans to current students had an out-of-school rate of 3.8 percent, the borrower's interest rate would automatically drop from 6.5

[149] For more information about historical interest rates on federal student loans, see http://www.gpo.gov/fdsys/pkg/FR-2013-01-25/pdf/2013-01423.pdf and http://www.gpo.gov/fdsys/pkg/FR-2013-01-25/pdf/2013-01421.pdf.

percent to 5.8 percent, so that the rate was no more than two percentage points above the current rate.

The interest rate on affected One Loans would not rise back up, even if rates in the economy increase. This helps borrowers who go to school when interest rates are unusually high, while avoiding the uncertainty and risk of a variable rate for all borrowers. We believe this interest-rate insurance, which has some similarities to existing financial instruments (e.g., swaptions[150]), can be provided at a reasonable cost to both borrowers and taxpayers, and incorporated into the fixed margin in the out-of-school interest rate. The cost of this feature will depend on the selected interest rate margin, universal cap, and the specifics of the insurance.

- **Interest-free deferments for Pell Grant recipients.**
  In addition to the One Loan's low in-school rate, universal interest-rate cap, and interest-rate insurance, which apply to all borrowers, the One Loan provides additional protection to borrowers from low-income families. Pell Grant recipients who take out One Loans would be eligible for interest-free deferments during periods of unemployment and economic hardship, just as with subsidized Stafford Loans currently.[151]

  Subsidized Stafford Loans do not accrue interest while the borrower is in school, during the six-month grace period,[152] or when payments are deferred for certain reasons after the borrower leaves school, including during periods of unemployment and the first three years in IBR if income-based payments are less than monthly interest. However, as mentioned above, these valuable benefits are not well targeted for several reasons: high-income students may qualify for subsidized loans just because they attend a high-cost college; and the vast majority of students with subsidized loans also have unsubsidized loans, which accrue interest during these periods.

  The One Loan better targets these valuable benefits to the borrowers who most need them, when they need them most. Borrowers who received Pell Grants, by definition, come from low-and moderate-income families and are therefore much less likely to have family members who can support them during periods of unemployment or low earnings. The One Loans provide interest relief on all loans held by Pell recipients, rather than just some of their loans, when they are unemployed or their incomes are too low to cover the interest in an income-based repayment plan.

- **Retain current loan limits.**
  The One Loan has the same aggregate loan limits as Stafford Loans: $31,000 for dependent undergraduates and $57,500 for independent undergraduates. As discussed in Section 1, student loans have become a fact of life for more and more Americans, and there is widespread and understandable concern about high and pervasive debt levels.

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[150] For information on this example, see http://en.wikipedia.org/wiki/Swaption.
[151] For more information about existing deferments for federal student loans, see http://studentaid.ed.gov/repay-loans/deferment-forbearance.
[152] The grace period interest subsidy was temporarily eliminated for loans issued in 2012-13 and 2013-14.

Federal loan limits provide a necessary signal to students and colleges about how much borrowing might be too much. The higher loan limits for independent students rightly recognize that these students have greater financial responsibilities and may need to borrow more to stay and succeed in school.[153]

Some have suggested raising the current loan limits, while others have suggested lowering them, but the data do not support either suggestion.[154] As mentioned earlier, average debt for 2011 graduates of public and nonprofit four-year colleges was well below the aggregate limits—the average including private loans was $26,600 for the two-thirds who borrowed, and one-third of graduates had no student debt.[155] The majority of undergraduates who borrow private education loans could have borrowed more in federal student loans before turning to the riskier private market.[156] Finally, colleges already have the authority to limit or deny loans for individual students on a case-by-case basis.[157]

The Department of Education should, however, analyze the potential effects of prorating federal student loans by attendance status. Unlike Pell Grants, federal loans are not prorated based on a student's attendance status. In other words, students enrolled half time receive a prorated portion of the Pell Grant that students enrolled full time receive, but may receive the same loan amount as a full-time student. Students who take out full loans but make only part-time progress may be at an increased risk of dropping out and defaulting. Students who attend college part time are less likely to complete a degree or certificate,[158] and failure to complete a degree or certificate is one of the strongest predictors of future default.[159] They may also be at greater risk of exhausting their loan eligibility before completing their degree. Prorating loans would involve reducing student eligibility for federal loans at a time when college is getting harder to afford, but it is possible that it could help encourage students to enroll in more courses per term, thereby completing a degree and reducing their risk of default. Given both the risks and the potential benefits, such a change warrants careful analysis and consideration.

Streamline and improve federal loan repayment options.

We have identified several ways to simplify and improve federal loan repayment options to help borrowers manage their debt, and reduce the financial distress and defaults that undermine the

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[153] For more information on independent students, see http://bit.ly/XXgAh5.
[154] For more information, see *Over-Borrowing" Not the Problem at For-Profit Colleges*: http://bit.ly/Xo5KTh and *Data Show No Evidence of "Over-Borrowing" at Community Colleges*: http://bit.ly/WYyge7.
[155] TICAS. 2012. *Student Debt and the Class of 2011*. http://projectonstudentdebt.org/files/pub/classof2011.pdf.
[156] TICAS. 2011. *Private Loans: Facts and Trends*. http://projectonstudentdebt.org/files/pub/private_loan_facts_trends.pdf.
[157] TICAS. 2012. *Making Loans Work*. http://projectonstudentdebt.org/files/pub/Making_Loans_Work.pdf.
[158] U.S. Department of Education, National Center for Education Statistics. 2011. *Six-Year Attainment, Persistence, Transfer, Retention, and Withdrawal Rates of Students Who Began Postsecondary Education in 2003-04*. http://nces.ed.gov/pubs2011/2011152.pdf.
[159] Gross, Jacob P.K., Osman Cekic, Don Hossler, and Nick Hillman. 2009. *What Matters in Student Loan Default: A Review of the Research Literature*. Journal of Student Financial Aid. Vol. 39 No. 1. http://bit.ly/VPFaV5. Education Sector. 2011. *Degreeless in Debt: What Happens to Borrowers Who Drop Out*. http://www.educationsector.org/sites/default/files/publications/DegreelessDebt_CYCT_RELEASE.pdf.

goals of increased enrollment and completion. There is even more complexity on the repayment side of the federal loan process than on the borrowing side. The number of repayment options and the variation in eligibility requirements, costs, and benefits can be overwhelming, even for those working in the field. With so many choices and variables, comparisons can become unwieldy and confusing, and borrowers may be more likely to end up in plans that do not fit their needs or goals. However, having some well-designed choices, combined with timely and effective counseling, can help borrowers find a good fit for their own situation, stay in repayment, and avoid default.

Let borrowers make one loan payment for all their federal loans.

To reduce complexity and make it easier to stay current on their loans, we recommend that borrowers be able to make a single payment that covers all of their federal loans. Currently, this can only be accomplished though a separate consolidation process, which is a significant bureaucratic hurdle for borrowers and has tradeoffs that are not in every borrower's best interest.[160] Borrowers should not have to consolidate their loans just to avoid making multiple payments to multiple servicers on their federal student loans each month.

Base repayment plan eligibility on total federal loan debt.

The "standard" repayment plan for unconsolidated federal loans is currently a 10-year plan. Borrowers are automatically enrolled in this plan if they do not actively choose a different one before their first payment.[161] If borrowers owe more than $30,000, they may be able to choose an "extended" 25-year plan instead, but only if they owe that much within one loan program.[162] For example, if they owe $31,000 in Federal Family Education Program (FFEL) Loans or $31,000 in Direct Loans, they may qualify for the extended plan. But if they owe $15,000 in Direct Loans and $16,000 in FFEL Loans, they do not qualify. In contrast, total federal student loan debt, along with the borrower's income, is used to determine eligibility for income-based repayment plans, in which borrowers pay for up to 20 or 25 years.[163] Meanwhile, borrowers who combine their loans into a Direct Consolidation Loan have access to "standard" repayment plans that gradually increase from 10 to 30 years[164] depending on the borrowers' total federal loan debt.[165] Any signal to borrowers about optimal repayment periods, if one were ever intended, gets lost in all this complexity, and what is optimal to one borrower may not be for another.

We recommend instead that all borrowers have access to repayment plans based on their *total* federal student loan debt, with incrementally longer repayment periods available to those with

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[160] For more information about federal loan consolidation, see http://studentaid.ed.gov/repay-loans/consolidation.

[161] U.S. Department of Education. 2010. *Exit Counseling Guide for Federal Student Loan Borrowers.* www.direct.ed.gov/pubs/exitcounselguide.pdf.

[162] For more information about the extended repayment plan, see http://studentaid.ed.gov/repay-loans/understand/plans/extended.

[163] All of the borrower's Direct and FFEL loans count in determining eligibility for IBR and Pay As You Earn, with the exception of Parent PLUS and consolidation loans that repaid Parent PLUS loans. For more information, see http://studentaid.ed.gov/repay-loans/understand/plans/income-based and http://studentaid.ed.gov/repay-loans/understand/plans/pay-as-you-earn.

[164] Depending on total educational indebtedness, a borrower with a Direct Consolidation Loan has access to a "standard" repayment period of 10, 12, 15, 20, 25, or 30 years in a non-income-based plan. For more information, see the U.S. Department of Education. *Direct Consolidation Loans.* Table entitled "Standard and Graduated Repayment Plan Repayment Periods." http://loanconsolidation.ed.gov/examples/repyperiod.html.

[165] The Direct Consolidation Loan program defines total debt for this purpose as total Direct Loan debt plus FFEL debt up to the same amount as the Direct Loan total. For more information about the definition, see http://1.usa.gov/WBrewl.

larger total debt. Making these repayment options consistent for all loans would greatly simplify the process for borrowers, especially when paired with improved loan counseling that helps them identify their priorities and see which plan is the best fit. Borrowers who want to reduce the overall cost of their debt by paying it down faster will be able to select shorter repayment plans and make prepayments without penalty, as they can now. Borrowers who want assurance that their monthly payments will remain affordable, given their income, will have access to a streamlined income-based plan, as discussed in detail below. Additionally, borrowers who want all their payments to count towards Public Service Loan Forgiveness will always be able to choose a 10-year payment plan.[166]

Currently, as mentioned above, borrowers who do not select a repayment plan are automatically placed in a 10-year plan, making the 10-year plan the "default" plan. A 10-year plan has significant benefits for borrowers *if* they can afford the monthly payments, which are higher than the monthly payments in longer plans. Given the growth in student debt levels over the past generation, a 10-year plan may be increasingly unrealistic for many borrowers.[167] Automatically enrolling borrowers in this plan, regardless of their total debt levels, could be setting some borrowers up to fail.

Nevertheless, there are trade-offs between shorter and longer repayment plans. Longer repayment periods provide lower monthly payments, but also cost borrowers more over the life of the loan. The best plan for one borrower may not be the best for another borrower. The decision of which repayment plan is most appropriate for any given borrower – whether made by the individual or by the Department through the selection of a "default" plan – is important and needs to be considered carefully. As we discuss later in this section, loan counseling should be improved to help borrowers decide which plan is best for them. The Department should also carefully analyze data on borrowers' repayment plan choices and outcomes – including their ability to make payments and total amount paid – to determine whether a 10-year plan remains the best option for borrowers who do not actively select another plan. The Department should also consider the broader implications of changing the default repayment plans for borrowers, colleges, and taxpayers.

Give all borrowers access to a single, improved income-based repayment plan.
When Congress created the Income-Based Repayment plan (IBR) for federal loans in 2007, it was a major step forward for student loan borrowers.[168] TICAS, through its Project on Student Debt, developed the policy proposal that laid the groundwork for IBR.[169] We first consulted with stakeholders on all sides and conducted an in-depth analysis of debt burdens and repayment plans. This analysis found that protections and options for borrowers with high debt relative to

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[166] For more information about the payments that qualify for Public Service Loan Forgiveness, which include 10-year payments and payments made in income-based plans, see http://1.usa.gov/OjQn3p.
[167] For example, in 2008, one in 10 graduates from four-year colleges had at least $40,000 in student loans, up from just three percent in 1996 (using constant 2008 dollars). TICAS. 2010. *High Hopes, Big Debts*. http://bit.ly/YN6wZ5.
[168] IBR was created as part of the College Cost Reduction and Access Act of 2007: http://1.usa.gov/UQfQy7.
[169] "Petition for Rulemaking to Amend Title 34, Sections 682.210, 685.204, and 685.209 of the Code of Federal Regulations." 2006. Signed by American Student Assistance, the College Board, College Parents of America, the Council for Opportunity in Education, Great Lakes Higher Education and Affiliates, The Howard Center for Family, Religion and Society, TICAS' Project on Student Debt, State Public Interest Research Groups, and the United States Student Association. http://projectonstudentdebt.org/files/File/Petition_to_ED_5.2.06.pdf.

their income were inadequate, inconsistent and inaccessible.[170] With America's higher education system increasingly reliant on student loans, and the consequences of default so severe and long-lasting, students were bearing too much of the risk to ensure access or support success. We developed a "Plan for Fair Loan Payments" that called for affordable payments based on income and family size, coverage of both Direct and FFEL loans, and a light at the end of the tunnel with forgiveness after 20 years of income-based payments. These goals were supported by thousands of students, higher education leaders, loan industry representatives, civil rights groups, Republicans and Democrats in Congress, and organizations representing parents, college counselors, and others.[171]

Thanks to the broad coalition that helped make the case for a solution, IBR became available to all federal loan borrowers in July 2009.[172] Despite the absence of much publicity or borrower outreach in the first few years of the program, more than 1.3 million borrowers were enrolled in IBR by the winter of 2012.[173] IBR caps monthly payments at a manageable share of income and forgives any principal or interest that remains after 25 years of payments. To qualify, borrowers must have a "partial financial hardship," defined as a debt-to-income ratio that makes a 10-year payment unaffordable. Required payments can be as low as $0 for borrowers with very loan incomes, and payments rise incrementally with income. Payments are capped at 15 percent of "discretionary income," which is defined as adjusted gross income (AGI) minus 150 percent of poverty for the borrower's family size.[174]

In recent years, the number of repayment options similar, but not identical, to IBR has grown. In early 2010, Congress passed the president's proposal to expand IBR for future borrowers.[175] Starting in 2014, new borrowers will be able to qualify for a lower monthly payment and shorter forgiveness period than the current IBR program provides: 10 percent of discretionary income and 20 years, instead of 15 percent and 25 years. In the fall of 2010, President Obama announced a new Pay As You Earn plan to give an estimated 1.6 million current students and recent graduates access to the same lower payment cap and shorter forgiveness period, with the goal of offsetting the recession's effect on their job prospects and earnings.[176] To qualify for Pay As You Earn, students must have borrowed their first loan after September 31, 2007 and received at least one federal loan disbursement after September 31, 2011. Pay As You Earn became available to eligible borrowers in December 2012 through regulatory additions to a preexisting program called Income-Contingent Repayment (ICR), which is only available for borrowers with Direct

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[170] TICAS. 2006. *Addressing Student Loan Repayment Burdens: Strengths and Weaknesses of the Current System.* http://ticas.org/pub_view.php?idx=103.
[171] For more information about the Plan for Fair Loan Payments and support for its goals, see http://bit.ly/VLVlbj.
[172] TICAS. June 30, 2009. Press release. "New Federal Income-Based Repayment Plan Goes Into Effect July 1." http://ticas.org/files/pub/July_1_IBR_Alert.pdf.
[173] U.S. Department of Education. January 2, 2013. *Homeroom: The Official Blog of the U.S. Department of Education.* "New Student Loan Repayment Option to Help Recent Graduates." http://www.ed.gov/blog/2013/01/new-student-loan-repayment-option-to-help-recent-graduates/.
[174] For more information about IBR, see http://studentaid.ed.gov/repay-loans/understand/plans/income-based and http://IBRinfo.org.
[175] The White House. 2010. *Ensuring That Student Loans are Affordable.* http://1.usa.gov/d32TEd.
[176] The White House. October 25, 2011. Press release. "We Can't Wait: Obama Administration to Lower Student Loan Payments for Millions of Borrowers." http://1.usa.gov/t63akG. See also TICAS. December 20, 2012. Blog post. "Pay As You Earn Now Available to Help New College Grads." http://views.ticas.org/?p=956.

Loans.[177] ICR, which is still available, provides less relief than IBR in most cases. Direct Loan borrowers in any of these repayment plans who *also* work for public or nonprofit employers may have their loans discharged after just 10 years of payments, through the Public Service Loan Forgiveness plan Congress created at the same time as IBR.[178]

We recommend consolidating the well-intentioned but highly complex mix of currently available income-based plans – current IBR, IBR for new borrowers in 2014, Pay As You Earn, and ICR – into one new and improved income-based plan. Borrowers will no longer have to figure out which plans they qualify for or which of their loans will be covered by which payment cap or forgiveness period. Those already enrolled in IBR, Pay As You Earn, and ICR would have the option of staying put or switching to the new plan. For the purposes of this paper, we refer to the new plan as Pay As You Earn 2 (PAYE2).

To simplify, strengthen, and improve access to income-based payments, PAYE2 will:

- **Be available to all borrowers, regardless of their debt or income level, whether their loans are Direct or FFEL, or when they borrowed.**
  This will make it much easier for borrowers who want the assurance of manageable payments to enroll whenever it makes sense for them, whether it is before they make their first payment, after they have hit a rough patch, or when they are concerned about what the future will bring. Rather than requiring borrowers to have a certain debt-to-income ratio to enroll, borrowers with higher income relative to their debt will simply make larger payments as determined by the plan's sliding scale. This is already the case for those whose incomes rise substantially after they entered an income-based plan. If borrowers have access to even lower monthly payments in another plan, and that is more important to them than the assurance of income-based payments, they need not enroll in PAYE2.

  Enabling all borrowers to enroll in PAYE2 will likely require adjustments in some aspects of income-based plan design, such as the treatment of accrued interest, when to capitalize interest and how much, and whether and how borrowers can exit and re-enter PAYE2. Further study is needed to determine optimal approaches. These changes will affect the benefits and risks of widespread enrollment in PAYE2.

- **Ensure payments never exceed 10 percent of income while better targeting benefits.**
  In its current design, Pay As You Earn has undeniable benefits for low- and moderate-income borrowers, but it may also result in some high-income borrowers getting substantial forgiveness when they could well afford to pay more. PAYE2 includes two adjustments that better target benefits while assuring that monthly payments never exceed 10 percent of the borrower's income and avoiding arbitrary cliffs, in which borrowers in very similar situations get very different benefits. These adjustments are:

[177] For more information about ICR, see http://studentaid.ed.gov/repay-loans/understand/plans/income-contingent.
[178] For more information about Public Service Loan Forgiveness, see http://studentaid.ed.gov/repay-loans/forgiveness-cancellation/charts/public-service and http://www.ibrinfo.org/what.vp.html#psll.

- *Gradually phase out the "income exclusion" for higher income borrowers.*
  PAYE2, like IBR and Pay As You Earn, calculates monthly payments based on the borrower's "discretionary income" –AGI minus an "income exclusion" to protect income needed to cover basic living expenses. Currently, in IBR and Pay As You Earn, the income exclusion is 150 percent of the poverty level for the borrower's household size. Based on this definition, a borrower with a family of four and an AGI of $40,000 has $34,575 protected for basic living expenses. The family therefore has a discretionary income of $5,425, or $452 per month, so payments set at 10 percent of discretionary income would be $45 per month.[179]

  However, as borrowers' incomes rise, it becomes increasingly unnecessary to shield a share of their earnings. Borrowers with very high incomes are able to devote a larger share of their total incomes to loan payments and still have sufficient funds left over to cover basic necessities, such as food and housing. As a result, PAYE2 gradually phases out the income exclusion for borrowers with AGIs between $100,000 and $250,000, so that borrowers with AGIs of $250,000 or more would have their monthly payments calculated as 10 percent of their total AGI. Borrowers with AGIs below $100,000 would not be affected, and monthly payments for all borrowers would never be greater than 10 percent of their total income. The AGI levels at which the phase-out begins and ends would be indexed to inflation to ensure fairness over time.

- *Cap all monthly payments at 10 percent of income.*
  Currently, in IBR and Pay As You Earn, some borrowers can end up paying less than 10 percent of their income due to a certain cap on their monthly payments. This occurs if, after entering IBR or Pay As You Earn, the borrower's income rises high enough that he no longer has a "partial financial hardship" (i.e., his debt-to-income ratio has declined so much that that a 10-year payment is now affordable). When this occurs, his payments are capped at the monthly amount he would have had to pay had he entered a 10-year standard repayment plan when he entered IBR. For some high-income borrowers, this cap will be lower than 10 percent of their income. Removing the current 10-year-payment cap and instead capping payments at 10 percent of income better targets income-based repayment benefits to those who need them and prevents high-income borrowers from receiving substantial loan forgiveness when they could have afforded to pay more.

- **Provide forgiveness after 20 years of payments.**
  As we have long recommended, any debt remaining after 20 years of income-based payments should be discharged. This will make it easier for borrowers to see the light at the end of the tunnel and let them focus on saving for retirement and their children's education before the next generation is in college. The changes to payment determinations described above better target the forgiveness available after 20 years,

[179] Calculations by TICAS based on data from the U.S. Department of Health and Human Services, "2012 HHS Poverty Guidelines," http://aspe.hhs.gov/poverty/12poverty.shtml.

because higher income borrowers will be more likely to pay off all or most of their debt within that period.

Make it easy for all borrowers in income-based plans to keep their income information up to date.

Regardless of how many income-based plans there are, there is a need to further improve the process through which borrowers provide updated income information to their loan holders. Currently, borrowers in income-based plans must provide tax or other income information each year to avoid reverting to non-income-based payments that may be much higher than they can afford. Recent improvements require that borrowers be notified before they have to submit information and make it easier for some borrowers to submit it to their servicer.[180] Additionally, in late 2012, the Department launched a user-friendly tool that lets borrowers electronically transfer their own tax information from the Internal Revenue Service (IRS) into an online form, both to apply for income-based plans and to update their income information.[181] Unfortunately, this process is only available to borrowers who have filed an IRS 1040 form. Borrowers with incomes too low to owe federal income tax may not have a 1040 form to draw from, requiring them to go through extra steps to verify their income. As a result, borrowers with the greatest need for income-based payments may have the hardest time continuing to qualify for them.

Just as we have recommended in Section 2 for the parallel system now used to prepopulate the FAFSA with applicants' 1040 data, the income verification process for PAYE2 should also draw on earnings data in borrowers' W-2 forms to simplify the process for all borrowers. In addition, borrowers should be able to give the Department advance permission to access their AGI and W-2 information for some period of time (e.g., five years), as they could until recently for IBR and ICR,[182] to reduce the risk of inadvertently missing a deadline.

Do not treat forgiven loan balances as taxable income.

Borrowers currently enrolled in IBR, ICR, and Pay As You Earn, as well as those who would be enrolled in our proposed PAYE2 plan, can have their loan balances forgiven after 20 or 25 years (depending on the program) of qualifying payments. As explained in more detail in Section 6, these forgiven loan amounts should not be treated as taxable income. Treating discharged loans as taxable income creates a tax liability that most recipients will be unable to afford, discourages enrollment in income-based repayment plans, and is inconsistent with the treatment of other discharged loans.

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[180] For more information, see the U.S. Department of Education. November 1, 2012. Federal Register Notice, Docket ID ED-2012-OPE-0010. Final regulations on the Federal Perkins Loan Program, Federal Family Education Loan Program, and William D. Ford Federal Direct Loan Program. http://www.gpo.gov/fdsys/pkg/FR-2012-11-01/pdf/2012-26348.pdf.

[181] U.S. Department of Education. December 21, 2012, updated January 11, 2013. Electronic Announcement. "Loan Servicing Information - Availability of Pay As You Earn Repayment Plan and Electronic IBR/Pay As You Earn/ICR Repayment Plan Request." http://ifap.ed.gov/eannouncements/122112LSIPayAsYouEarnPlanIBRnICR.html.

[182] See, for example: "William D. Ford Federal Direct Loan Program Income Contingent Repayment Plan & Income-Based Repayment Plan Consent to Disclosure of Tax Information." OMB No. 1845-0017. Available online, as of February 10, 2013, at http://loanconsolidation.ed.gov/forms/icr.pdf. Borrowers used this form to authorize the IRS to provide their income information for five years (2008-2012). It expired on June 30, 2012.

Improve the timing, content, and effectiveness of student loan counseling.

Federal law and regulations require entrance and exit counseling for any student who receives a federal loan.[160] Entrance counseling has the potential to help students optimize their borrowing and better understand the risks and benefits, and exit counseling has the potential to help students select an appropriate repayment plan and avoid default. However, the timing and content of required counseling must be improved to better help students borrow wisely, complete college without burdensome debt, and repay their loans. With common-sense modifications and more research on what works, loan counseling can more effectively inform crucial decisions about borrowing and repayment.

Loan counseling should be conducted when it is most likely to have an impact.
That means entrance counseling should happen *before* students commit to borrowing. Currently, entrance counseling can occur after the promissory note is signed, as long as the counseling comes before the first loan disbursement. This timing problem can and must be fixed. Also, while entrance counseling is only required when students first borrow, interim counseling should take place at key points when borrowers are likely to benefit, such as when they have borrowed over a certain amount or sought certification of a private loan.

Loan counseling must be individualized based on the borrower's specific situation and needs, not just disclose general information and options.
Entrance counseling could give students an estimate of their total debt burden if they borrow the amount they are seeking in each year they plan to be in school, and the resulting monthly and total payments under different plans. Exit counseling could ask students about their plans and preferences and point them toward specific repayment plans based on this information. For instance, if a student has borrowed a small amount and has secured a job with sufficient pay, the counseling might encourage her to select a 10-year fixed payment plan to minimize the total amount she will pay over the life of the loan. On the other hand, if the student has borrowed a large amount and is unsure how much she is likely to earn, the counseling might highlight income-based repayment as a way to keep her payments affordable. Currently, counseling does not have to be tailored to the individual student's situation and can, for example, use average loan amounts rather than the amount the student has actually borrowed.

The entrance and interim loan counseling should include warnings about the risks of private loans and discourage students from considering them if they have not exhausted their federal loan options.
Students need to understand the protections and benefits that come from federal loans, including set and predictable interest rates, flexible repayment plans, deferment options, and forgiveness programs, *before* they take out a private loan. To the extent possible, exit counseling should include any private loan debt so students can select a repayment plan for their federal loans based on an understanding of their total debt, including any private loans.

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[160] For information on current loan counseling requirements, see the U.S. Department of Education. 2012-13 *Federal Student Aid Handbook*. Volume 2, Chapter 6. http://ifap.ed.gov/fsahandbook/attachments/1213FSAHbkVol2Ch6.pdf. For information on the federal regulations regarding loan counseling, see http://bit.ly/XtgttB.

Finally, all loan counseling should be consumer tested and improved based on the feedback, and ongoing analysis should be conducted of counseling's impact on student decisions. For instance, existing data systems could be used to assess the impact of variations in entrance, interim, and exit counseling on student enrollment, persistence, borrowing, repayment, and default rates. Such analysis could be used to continually improve the counseling to better support student success, prevent loan defaults and unwise or unnecessary borrowing, and reduce the burden of student debt by helping students choose appropriate repayment plans.

Strengthen consumer protections to support smart borrowing, prevent default, and reduce financial distress for borrowers with federal and private loans.

For federal loan borrowers

As a form of financial aid, federal student loans provide many important consumer protections that are not required of private education loans or other types of financing. Examples include: discharges under circumstances such as school fraud, school closure, severe and permanent disability, or death; income-based repayment plans that assure affordable payments and a light at the end of the tunnel; deferments and forbearances that let borrowers temporarily suspend payments without becoming delinquent or paying additional fees; and an opportunity to reenter repayment after default. Such policies are supposed to prevent or reduce defaults, unfair treatment, and extreme financial distress for borrowers who used federal loans to help pay for their own or their child's education. Unfortunately, the federal loan system does not work as well as it should to protect borrowers in challenging circumstances. We suggest the following changes to help reduce red tape for distressed, disabled, or defrauded federal loan borrowers and better reduce and prevent defaults. While far from comprehensive, these recommendations touch on several important areas for improvement in ways that address the interests of both borrowers and taxpayers.

Respond to signs of financial distress in ways that can prevent default.

- *Ensure that borrowers receive key information about their repayment options not only before they make their first payment, but also when their payment patterns indicate likely financial distress.* For example, a dozen members of Congress recently urged the Secretary of Education to alert borrowers to the availability of IBR and related plans as soon as those borrowers have been delinquent, in forbearance, or in economic hardship or unemployment deferment for more than 60 days.[184] Despite efforts to make repayment more manageable, default rates have risen even among those who entered repayment after IBR became available.[185] Borrowers struggling to keep up with monthly payments clearly need this information and related counseling. Once distressed borrowers are aware of IBR and how it could help them, they might also benefit from information

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[184] September 28, 2012 letter to Education Secretary Arne Duncan from 12 members of the U.S. House of Representatives. For more information, see http://schwartz.house.gov/issue/higher-education

[185] TICAS. September 28, 2012. Press release. "Student Loan Default Rates Show Continued Borrower Distress: Income-Based Repayment Plan Could Help More Borrowers Avoid Default." http://ticas.org/files/pub//Release_CDRs_092812.pdf

about extended repayment plans, deferments, forbearances, and conditions for cancellation.

- *Automatically enroll severely delinquent borrowers in an income-based repayment plan.* It takes at least nine months of nonpayment to default on a federal student loan. The federal loan promissory note should require borrowers to give the Department permission to access their IRS information if they miss at least six consecutive payments. Using their income and family size, the Department could then determine what their income-based payment would be.[186] If it were less than their current payment, the Department would notify the borrower and, unless they chose another plan, automatically enroll the borrower in the income-based plan. For borrowers with very low incomes, income-based payments may be as little as $0, and income-based payments will be lower than 10-year payments for most borrowers under financial strain. By enrolling them and engaging in follow-up contact and counseling, the Department may be able to prevent otherwise very likely defaults and the associated costs for both borrowers and taxpayers. Notification and ease of use will be essential to this policy's effectiveness, as borrowers need to know that their payment has been lowered and how and why to update their income and family size at least annually.

Determine why most delinquent borrowers are not successfully contacted before they default. Data show that a significant number of borrowers who default were never successfully contacted by their lenders because their lenders did not have current contact information.[187] It will be very difficult to reduce default rates and help more borrowers enroll in affordable repayment plans if servicers and/or the Department lack accurate, up-to-date contact information for federal loan borrowers or functional systems for reaching them. The Department should conduct a study to determine the main causes of this serious problem, use the findings to identify needed changes, make any such changes that are within its authority, and recommend that Congress make additional changes if necessary.

Reconsider the use of private debt collectors for federal student loans.
Currently, the federal student loans collections process is almost entirely in the hands of private debt collection agencies.[188] These debt collectors are given the authority to act on behalf of the lender or guarantor in everything from rehabilitation of a defaulted loan to information about loan discharges to negotiating loan compromises. Because their contracts with the Department of Education provide bigger rewards for collecting larger dollar amounts, these debt collectors have a disincentive to inform borrowers of their rights or to set reasonable and affordable payment amounts based on the borrowers' financial circumstances, as required by law.[189] Given

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[186] Income would be adjusted gross income (AGI) or, if no tax form were available for the past two tax years, wages from W-2 forms. While the family size definition may not be identical to the U.S. Department of Education's definition, it is a proxy under these circumstances and can be amended by the borrower. For further discussion of the family size definition issue, see Section 2.

[187] U.S. Department of Education, Office of Federal Student Aid. Webinar, presented November 18, 2010. *Delinquency and Default Prevention Training.* http://www2.ed.gov/offices/OSFAP/training/materials/defaulttranscript.pdf. P. 27.

[188] U.S. Department of the Treasury. 2009. *Fiscal Year 2008 Report to the Congress:* U.S. Government Receivables and Debt Collection Activities of Federal Agencies. http://www.fms.treas.gov/news/reports/debt08.pdf.

[189] Hechinger, John. March 25, 2012. "Obama Relies on Debt Collectors Profiting From Student Loan Woe." *Bloomberg News.*

the commission structure and conflicts of interest, it is not surprising that the National Consumer Law Center has found a remarkable amount of deceptive, unfair, and illegal conduct by private collectors involving federal student loans.[190] Recent news investigations have also documented such conduct and the underlying "boiler-room" business model.[191]

Collections should prioritize the interests of borrowers and taxpayers, not collection agencies. With the Department of Education spending more than $1.4 billion a year on commission-based contracts with private debt collectors, an examination of whether outsourcing is the most effective or appropriate approach is long overdue.[192] In 2009, the IRS conducted an extensive review of its private collections contracts and moved to bring the function in-house.[193] The Treasury Department is responsible for the collection of debt owed to the federal government but has delegated to the Education Department the authority to collect on defaulted student loans.[194] We recommend that the Treasury Department withdraw the delegation of its authority for a randomly selected number of defaulted loans for the purpose of studying whether taxpayers' and borrowers' interests would be better served by collecting all defaulted federal student loans by trained Treasury employees rather than by private debt collectors.

Protect income that borrowers need for basic necessities.

Collection and rehabilitation policies for federal student loans should not force defaulted borrowers to choose between making a loan payment and keeping a roof over their head. In recognition that borrowers must pay for basic necessities like food and shelter before they can put anything towards their student loans, IBR payments are $0 for borrowers with income below 150 percent of the poverty level for their family size, with loan payments rising only as their income increases. For both ethical and practical reasons, the same minimum income protection should be built into federal loan collections and rehabilitation policies.

TICAS and other student and consumer organizations have long recommended that the nine "reasonable and affordable" payments required to rehabilitate a defaulted loan follow the IBR formula, but with a minimum payment of $5 instead of $0.[195] Since this issue was raised during negotiated rulemaking in 2012, the Department has reported that many of their collections contractors are using IBR as the initial threshold for "reasonable and affordable" payments. To build on this apparent progress, this practice must be formalized and required in all cases.

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http://www.bloomberg.com/news/2012-03-26/obama-relies-on-debt-collectors-profiting-from-student-loan-woe.html.

[190] Loonin, Deanne. National Consumer Law Center. Testimony before the U.S. Senate Judiciary Subcommittee on Administrative Oversight and the Courts, hearing entitled, "The Looming Student Debt Crisis: Providing Fairness for Struggling Students." Delivered March 20, 2012. http://www.judiciary.senate.gov/pdf/12-3-20LooninTestimony.pdf

[191] Hechinger 2012. Martin, Andrew. September 8, 2012. "Debt Collectors Cashing In on Student Loans." *The New York Times*. http://www.nytimes.com/2012/09/09/business/once-a-student-now-dogged-by-collection-agencies.html?pagewanted=all.

[192] Martin 2012.

[193] Internal Revenue Service. March 5, 2009. Press release. "IRS Conducts Extensive Review, Decides Not to Renew Private Debt Collection Contracts: IRS Employees More Flexible, More Cost Effective." http://www.irs.gov/uac/IRS-Conducts-Extensive-Review,-Decides-Not-to-Renew-Private-Debt-Collection-Contracts.

[194] As specified in 31 USC 3711g: "For purposes of this section, the Secretary of the Treasury may designate, and withdraw such designation of debt collection centers operated by other Federal agencies. The Secretary of the Treasury shall designate such centers on the basis of their performance in collecting delinquent claims owed to the Government."

[195] See, for example, public comments by TICAS at http://ticas.org/files/pub/TICASNegReg_Comments_5.20.2011.pdf.

Wage garnishment and offsets of tax refunds and Social Security benefits should also be subject to this approach to income protection.

Rethink default penalties to ensure that distressed borrowers have a way out.
While there should clearly be some penalties associated with defaulting on a federal student loan, they should not be designed to keep borrowers without financial means in default indefinitely, with already unmanageable debt just continuing to mount. For example, collection fees of up to 25 percent are currently added to what borrowers owe when they default, even if the actual costs of the collections activities were less.[196] These fees go to the private collection agencies discussed above. If a borrower went into default because she could not afford her loan payments, high fees make it even less likely that she will ever be able to get out of default. Another policy that can trap borrowers in default is limiting them to only one chance at rehabilitation. It is worth considering whether borrowers who redefault should be allowed to rehabilitate their loans more than once after some period of successful payments.

Ensure that borrowers who are abused or defrauded by a college can get relief.
The Department should use its full authority to enforce the law that relieves borrowers of debt resulting from illegal or abusive school practices. The "false certification" provisions in law are designed to offer relief for harmed students as well as to discourage illegal, abusive school practices. The law provides for the discharge of loans falsely certified by institutions and for the Secretary to recover the loans amounts from the schools and its affiliates. While the statutory authority is broad, the Department has interpreted these false certification provisions very narrowly, denying needed relief to borrowers who suffered harm at the hands of their school. Borrowers should be eligible for relief if, for example, a school improperly or falsely certifies a student's satisfactory academic progress,[197] enrolls students in career education programs that lack the programmatic accreditation necessary for employment in the occupation, enrolls students who do not speak English in programs taught only in English, or enrolls students with criminal records in programs that prepare them for employment in professions from which they are barred because of their criminal record. The regulations must be revised so that borrowers can count on relief from debts resulting from a school's harmful actions when there is reasonable evidence that the harm took place.[198]

For private loan borrowers

Private education loans are a much riskier way to pay for college than federal student loans. As mentioned earlier, interest rates on private loans are usually variable, like a credit card, and over the life of the loan will typically be much higher than the rates on federal student loans. Whether private loan rates are variable or fixed, lower income students often receive the worst rates and terms, and private loans do not have the important borrower protections and repayment options that come with federal loans. The following policy changes would help

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[196] U.S. Department of Education, Office of Federal Student Aid. "Debt Resolution: Collection Costs." https://www.myeddebt.com/borrower/collectionCostsNavigate.
[197] For examples of teachers being pressured to manipulate grades in order to retain students, see Field, Kelly. May 8, 2011. "Faculty at For-Profit Colleges Allege Constant Pressure to Keep Students Enrolled." *The Chronicle of Higher Education.* http://chronicle.com/article/Pawns-in-the-For-Profit/127424/.
[198] For more information, see TICAS' comments on false certification at http://ticas.org/files/pub/TICASNegReg_Comments_5.20.2011.pdf.

prevent students from unnecessarily taking out risky private loans, ensure that consumers have information they need to make wise borrowing decisions, and stop deceptive and predatory private lending practices.

Prevent unnecessary private loan borrowing by requiring school certification of private loans. The majority of undergraduates who borrow private education loans could have borrowed more in federal student loans before turning to the riskier private market.[199] Unfortunately, many students who borrow private loans – and the parents who co-sign these loans – do not understand the difference between federal and private loans until it is too late.[200] Requiring private lenders to confirm a borrower's eligibility with his or her school before disbursing the loan ensures the student is eligible for that loan and the loan amount. It also gives the school a chance to help the student make an informed borrowing decision. Before the credit crunch, about a third of all private loans to undergraduates were made *without* such school certification.[201] Currently, most lenders voluntarily ask schools to certify their private loans, but lenders are not required to do so, and changing credit conditions could once again create incentives to cut schools out of the loop. In addition, many schools do not take the opportunity to counsel students before certifying. Students, schools, and lenders, as well as the U.S. Consumer Financial Protection Bureau (CFPB) and Department of Education, have all endorsed requiring "school certification" of private loans, including notifying the student of any remaining federal aid eligibility before the loan is certified.[202] The CFPB could require such certification for all private loans, and legislation[203] introduced in 2013 (S. 113) would do so as well.

Treat private loans like other consumer debt in bankruptcy.
Since 2005, it has been much more difficult to discharge private education loans than credit cards and other consumer debt in bankruptcy, often leaving even the most destitute borrowers with no way out. A joint report to Congress from the CFPB and Department of Education found that this change coincided with rapid growth in questionable lending practices, compounding the risk to student borrowers.[204] It also found a lack of evidence to support industry claims that restricting bankruptcy rights improved loan prices or access to credit. House and Senate

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[199] TICAS. 2011. *Private Loans: Facts and Trends.* http://projectonstudentdebt.org/files/pub/private_loan_facts_trends.pdf.
[200] TICAS. 2011. *Critical Choices: How Colleges Can Help Students and Families Make Better Decisions about Private Loans.* http://projectonstudentdebt.org/pub_view.php?idx=766.
[201] U.S. Consumer Financial Protection Bureau and U.S. Department of Education 2012.
[202] See the December 10, 2009 letter signed by 25 organizations in support of mandatory certification. http://bit.ly/Y1gwUN. Also see the May 7, 2010 letter signed by lenders and others urging inclusion of mandatory school certification in the Senate financial reform bill, referenced in Lederman, Doug. May 11, 2010. "Unlikely Bedfellows on Student Loans." *Inside Higher Ed.* http://www.insidehighered.com/news/2010/05/11/certify.
[203] U.S. Senator Dick Durbin. January 23, 2013. Press release. "As student loan debt surpasses $1 trillion, senators introduce legislation to address crisis." http://1.usa.gov/WxsVYM.
[204] U.S. Consumer Financial Protection Bureau and U.S. Department of Education 2012.

legislation[205] would restore fair bankruptcy treatment to private loan borrowers and is supported by TICAS and a broad coalition representing students, consumers, and colleges.[206]

Enable private loan borrowers to refinance or modify their loans.

Borrowers who face unmanageably high payments on their private loans do not have access to lower payments through IBR or other federal repayment plans, and private lenders are not required to provide the types of repayment options and borrower protections that are built in to federal loans, such as unemployment deferments and forbearances without fees. Private loans typically have variable interest rates that are highest for the students and cosigners who can least afford them. Those who borrowed their loans at a high rate are often unable to refinance despite historically low interest rates in the economy, even if their current credit score would qualify them for a lower fixed or variable rate if they took out a loan today.[207] Keeping borrowers locked into high rates and high payments poses risks not only to their ability to meet basic needs, but also to retirement savings and homeownership, and to the broader economy as a result.[208] We recommend the CFPB and Congress develop standards for loan refinancing and/or modification to make private loan borrowers' debts more manageable.

Section 6: Tax Expenditures

As discussed in Section 1, current higher education tax provisions are too poorly timed and poorly targeted to efficiently increase college access or success. For these reasons, we recommend eliminating higher-education-specific tax benefits and redirecting the savings (more than $100 billion over the first five years) into Pell Grants and incentive funds for states and colleges to increase college access, affordability, and success.[209] However, there is strong bipartisan support for higher education tax benefits: the American Taxpayer Relief Act of 2012 (ATRA) included more than $90 billion (over a period of 10 years) in higher education tax benefits that would have otherwise expired, including the extension of two of the most

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[205] The Fairness for Struggling Students Act of 2013 (S. 114). Introduced January 23, 2013. http://thomas.loc.gov/cgi-bin/query/z?c113:S.114:. The Private Student Loan Bankruptcy Fairness Act of 2013 (H.R. 532). Introduced February 6, 2013. http://thomas.loc.gov/cgi-bin/query/z?c113:H.R.532:.

[206] See the coalition letter to Senator Durbin in support of the Fairness for Struggling Students Act of 2013, available at http://projectonstudentdebt.org/pub_view.php?idx=872, and the coalition letter to Representative Cohen in support of the Private Student Loan Bankruptcy Fairness Act of 2013, available at http://projectonstudentdebt.org/pub_view.php?idx=871.

[207] U.S. Consumer Financial Protection Bureau. 2012. *Annual Report of the CFPB Student Loan Ombudsman.* http://files.consumerfinance.gov/f/201210_cfpb_Student-Loan-Ombudsman-Annual-Report.pdf. Pp. 6, 15, and 19-20.

[208] Chopra, Rohit. U.S. Consumer Financial Protection Bureau. Testimony before the Senate Committee on Banking, Housing and Urban Affairs, Subcommittee on Financial Institutions and Consumer Protection. Delivered July 24, 2012. http://1.usa.gov/OsqctM. U.S. Consumer Financial Protection Bureau. 2012. *Annual Report of the CFPB Student Loan Ombudsman.* http://files.consumerfinance.gov/f/201210_cfpb_Student-Loan-Ombudsman-Annual-Report.pdf.

[209] Joint Committee on Taxation. 2012. *Estimates Of Federal Tax Expenditures For Fiscal Years 2011-2015.* https://www.jct.gov/publications.html?func=startdown&id=4386. Pp. 40-41.

regressive and poorly targeted benefits: the student loan interest deduction and the tuition and fees deduction.[210]

If Congress is unwilling to eliminate the current higher education tax benefits and redirect the savings to Pell Grants, which more effectively and efficiently support college access and success, then we recommend dramatically streamlining and improving the targeting of higher education tax benefits. Specifically, *if* higher education tax benefits are to be retained, we recommend:

1. Streamline multiple higher education tax benefits into an improved American Opportunity Tax Credit (AOTC) that is better designed to increase college access and success.

2. Stop taxing forgiven or discharged student loans as income.

3. Stop taxing Pell Grants as income.

4. Better align eligibility for higher education tax benefits with eligibility for student grants and loans.

Streamline multiple higher education tax benefits into an improved American Opportunity Tax Credit (AOTC) that is better designed to increase college access and success.

Given the design of the American Opportunity Tax Credit (AOTC), research suggests it is the most likely of the current tax benefits to increase college access and success. This is because it provides some assistance to low-income students, who are more likely to be on the margin of attending and completing college due to financial need, liquidity constraints, and being more likely to be the first in their family to attend college. Research has also shown that low-income, minority, and community college students are more sensitive to tuition prices than other groups of students.[211] We therefore recommend extending and improving the AOTC by enhancing the benefits for low- and moderate-income students and for students attending community colleges. We pay for these changes by eliminating other less targeted, less effective tax benefits, including the tuition and fees deduction, student loan interest deduction, Lifetime Learning Credit and exclusion of earnings from Coverdell education savings accounts. The consolidation of tax benefits also greatly simplifies the tax code, which further increases the likelihood that the tax benefits will reach those who are at greatest risk of not starting or finishing college.

Our specific recommendations to improve the AOTC include:

- **Increase the AOTC's refundability.**
  The AOTC is the only higher education tax benefit that is refundable, enabling students

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[210] Joint Committee on Taxation. 2013. *Estimated Revenue Effects Of The Revenue Provisions Contained In An Amendment In The Nature Of A Substitute To H.R. 8, The "American Taxpayer Relief Act Of 2012," As Passed By The Senate On January 1, 2013.* https://www.jct.gov/publications.html?func=startdown&id=4497.

[211] Center on Budget and Policy Priorities. Unpublished memo, last revised November 2012.

and families with incomes too low to pay federal income tax to benefit from it. However, the AOTC is only 40 percent refundable (up to $1,000 per year). As a result, low-income students can receive a maximum of $1,000 per year and $4,000 over four years from the AOTC, while students from families with higher incomes can receive up to $2,500 per year and $10,000 over four years. This provides the greatest assistance to those who need it the least and whose behavior is the least likely to be affected by the tax benefit. The AOTC should be 100 percent refundable. If 100 percent refundability is too costly, then refundability should be increased as much as possible with the savings from tax reforms.

- **Replace the AOTC's four-year cap with a lifetime-dollar cap.**
  Currently, the AOTC provides up to a $2,500 credit per student per year for up to four years, for a maximum $10,000 total benefit. However, there is no evidence to suggest that the current four-year limit affects student behavior, and as noted above, it effectively caps the maximum total benefit at $4,000 for the lowest income students and $10,000 for the highest income students. In addition, the four-year time limit can reduce the benefit for those who have to enroll less than full time or take more than four years to finish. To provide the same maximum benefit to all students and provide a tax benefit to those completing their degree while working full time, the AOTC time limit should be replaced with a lifetime cap of $10,000.

- **Index the AOTC credit amounts and income limits to inflation.**
  The maximum annual benefits under the HOPE Credit and Lifetime Learning Credit are both indexed to inflation, while the AOTC's maximum annual benefit of $2,500 set in 2009 is not. Similarly, the income eligibility limits for the Hope Credit and Lifetime Learning Credit are both indexed to inflation, while the AOTC's income eligibility limits are not. The AOTC's annual and lifetime dollar caps, as well as the AOTC's income thresholds, must be indexed to inflation to prevent the AOTC's inflation-adjusted value and eligibility limits from declining over time.

- **Better target the AOTC to increase its impact on access and success.**
  While the AOTC provides greater benefits to lower income students than the non-refundable HOPE Credit, it also provides much greater benefits to higher income students and families as shown in the chart below.[212] Where eligibility for the HOPE Credit phases out for joint filers with incomes between $107,000 and $127,000 in 2013, eligibility for the AOTC phases out for joint filers with incomes between $160,000 and $180,000.[213]

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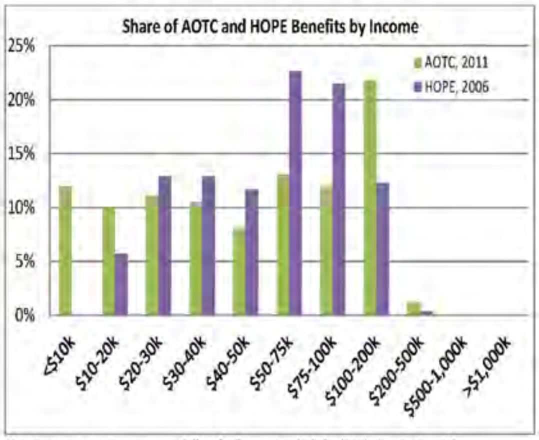
[212] Center on Budget and Policy Priorities. Unpublished memo, last updated November 2012. Calculations by the Center on Budget and Policy Priorities on data from the Tax Policy Center, Tables T11-0303 and T07-0249.

[213] The HOPE Credit phases out for single and head of household filers with incomes between $53,000 and $63,000, while the AOTC phases out for such filers with incomes between $80,000 and $90,000.



Note: Income categories are current dollars for the year in which the distribution is estimated.

In fact, dependent students with family incomes over $100,000 account for 15 percent of undergraduate students but receive 22 percent of AOTC benefits.[214] Students from such families are among the most likely to attend and complete college even without this benefit. Their families also receive the greatest tax benefits from 529 college savings accounts and are among the most likely to have such accounts.[215] To maximize the potential impact of the AOTC on college access and success, eligibility should phase out at the lower, preexisting HOPE Credit levels, indexed to inflation. If this is not viable, then at a minimum, AOTC eligibility should begin phasing out earlier—at $107,000 for joint filers like the HOPE Credits—while completely phasing out near or at the current maximum AOTC level ($180,000 for joint filers). This would help to prevent higher income families from receiving a disproportionate share of the AOTC and would better target benefits to those with the greatest need and whose college access and success is less assured.

- **Include transportation and child care costs as AOTC qualified expenses.**
  The U.S. Department of Education (the Department) and colleges include transportation and an allowance for child care in the full cost of college attendance, because students need to be able to get to and from campus (unless they are enrolled exclusively online) and arrange for the care of their children while studying. Both transportation and child care costs can be substantial for students who incur them and can account for a

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[214] U.S. Department of Education, National Center for Education Statistics. 2010. *Web Tables - Profile of Undergraduate Students, 2007-08.* Table 3.5-A. "Percentage distribution of undergraduates, by dependency status and income level in 2006, and selected institutional and student characteristics: 2007–08." http://nces.ed.gov/pubs2010/2010205.pdf#page=72.

[215] Dynarski, Susan. 2004. *Who Benefits from the Education Savings Incentives? Income, Educational Expectations, and the Value of the 529 and Coverdell.* National Bureau of Economic Research. Working Paper 10470. http://www.nber.org/papers/w10470.pdf. U.S. Department of the Treasury. 2010. *The American Opportunity Tax Credit.* http://www.treasury.gov/resource-center/tax-policy/Documents/American-Opportunity-Tax-Credit-10-12-2010.pdf.

significant portion of the total cost of attendance. However, these costs are not currently considered qualifying expenses for the AOTC. To increase impact and consistency, we recommend that reasonable transportation and child care costs be considered qualifying expenses for the AOTC, just as they are eligible expenses for federal student aid. As a result, qualifying AOTC expenses would include tuition, fees, course-related books, supplies, equipment, and reasonable transportation and child care expenses. However, for students enrolled in entirely online programs, transportation expenses should *not* be considered qualified expenses for either federal student aid or tax benefits, and excluding such expenses may help reduce online student aid fraud as discussed in Section 2.

- **Adjust the AOTC benefit calculation to provide greater assistance to students with unmet need attending low-tuition colleges, such as community colleges.**
  Currently, the AOTC provides a 100 percent credit for the first $2,000 of qualified expenses and a 25 percent credit for the next $2,000 in expenses, for a maximum annual credit of $2,500 based on $4,000 of qualified expenses. In contrast, the HOPE Credit provides a 100 percent credit for the first $1,200 in expenses and a 50 percent credit for the next $1,200 in expenses, for a maximum credit of $1,800 per year. We recommend the AOTC benefit calculation be adjusted to cover 100 percent of the first $2,000 in expenses and 50 percent of the next $1,000, with the annual threshold amounts indexed to inflation. This change lowers the total out-of-pocket expenses necessary to receive the maximum AOTC to $3,000 from $4,000, providing a greater benefit to students with less than $4,000 in expenses. This would be especially helpful for lower income students who attend lower cost colleges (like community colleges) but still have significant unmet financial need after accounting for aid.

- **Study ways to deliver AOTC benefits at the time students incur expenses, rather than months later.**
  As discussed in Section 1, one of the major weaknesses of higher education tax benefits is that they are provided well after the costs of college are incurred. This reduces their impact on enrollment and persistence, especially for low-income students, who are the most likely to face cash constraints. As the economist Bridget Terry Long concluded, "While the [education] tax credits could encourage enrollment, the delay between the activity and receipt of the aid may reduce the likelihood of any effect…credits do not help individuals for whom liquidity is the reason they do not attend college."[218] Given the billions of dollars dedicated to higher education tax benefits, the Treasury and Education Departments should jointly study or commission research and analysis to identify ways to deliver tax benefits when students incur the costs of education, rather than months afterwards.

- **Eliminate other less targeted tax benefits and use the savings to improve the AOTC.**
  ATRA extended the AOTC for five years, through 2017, while making other less targeted

[218] Long, Bridget T. 2004. "The Impact of Federal Tax Credits for Higher Education: College Choices: The Economics of Where to Go, When to Go, and How to Pay For It." Pp. 101-168 in *College Choices: The Economics of Where to Go, When to Go, and How to Pay For It*, edited by Caroline M. Hoxby. Chicago, IL: University of Chicago Press. http://www.nber.org/chapters/c10099.pdf.

and less effective tax benefits permanent. We recommend eliminating the following less targeted tax provisions beginning in 2014:

- *Student Loan Interest Deduction.*
  This "above-the-line" deduction allows student loan borrowers with incomes up to $160,000 to deduct up to $2,500 in student loan interest payments each year, for the life of the loan, regardless of whether they itemize their taxes.[237] Because it is a deduction and is now permitted for the life of the loan, it is among the most regressive tax benefits, giving the greatest benefit to those with the highest incomes. It is also among the most poorly timed to influence students' decisions as it provides benefits years after the borrower has left school. Because it is a deduction, it also undermines the targeting of the Income-Based Repayment (IBR) and related federal loan repayment plans, which cap monthly loan payments based on the borrower's Adjusted Gross Income (AGI). This leads to a double benefit—the tax deduction lowers borrowers' AGI, which further lowers their monthly loan payments—that is greater for those with higher incomes and debts. If it is not viable to eliminate the deduction entirely, then at a minimum, the 2001/2012 expansions should be eliminated immediately and the underlying deduction phased out over a period of 10 years. Eliminating this deduction is estimated to save $20 billion over 10 years.[238]

- *Tuition and Fees Deduction.*
  This "above-the-line" deduction allows taxpayers with incomes up to $130,000 to deduct $4,000 spent on tuition and fees each year, and those with incomes between $130,000 and $160,000 to deduct $2,000, regardless of whether they itemize their taxes.[239] Because it is a deduction rather than a credit and has such high income limits, it is highly regressive. It is also unnecessary in light of the better targeted AOTC. Moreover, this benefit greatly adds to the complexity of the tax code because the deduction is per household, rather than per student like the AOTC, and filers cannot claim this deduction for one dependent and the AOTC for another dependent in the same year. This deduction should be

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[237] In 2013, the phase-out ranges are $130,000-$160,000 for joint filers and $65,000-$80,000 for single filers and heads of household. Prior to 2002, eligibility for the student loan interest deduction phased out at $60,000-$75,000 for joint filers and at $40,000-$55,000 for single filers and heads of households, indexed to inflation, and taxpayers could deduct interest payments for up to five years (60 months). The Economic Growth and Tax Relief Reconciliation Act of 2001 significantly raised the income limits and allowed deductions beyond five years. ATRA made permanent the expanded deduction, indexed to inflation.

[238] New America Foundation. 2013. *Rebalancing Resources and Incentives in Federal Student Aid.* http://newamerica.net/sites/newamerica.net/files/policydocs/NAF_Rebalancing%20Resources%20FINAL.pdf. P. 29.

[239] Joint filers with income below $130,000 and single filers and heads of household with income below $65,000 are eligible for a $4,000 deduction. Joint filers with income between $130,000 and $160,000 and single filers and heads of household with income between $65,000 and $80,000 are eligible for a $2,000 deduction. Filers with incomes above these levels are ineligible. ATRA retroactively restored the tuition and fees deduction, which had expired on December 31, 2011, and extended it through December 31, 2013.

allowed to expire as scheduled on December 31, 2013. Eliminating this deduction would save an estimated $7 billion over 10 years.[220]

- *Lifetime Learning Credit.*
  Tax filers can receive up to a $2,000 tax credit for each year that they pay tuition and fees for an undergraduate or graduate program or for individual courses taken to improve job skills. This credit may be claimed for an unlimited number of years but, unlike the AOTC, it can only be claimed once per tax return even if more than one person in the family is a student. Regardless of the amount of tuition and fees paid, the Lifetime Learning Credit and AOTC cannot be claimed for the same student in the same year. Eliminating the Lifetime Learning Credit would simplify the tax code by eliminating the need for families and students to evaluate which credit is appropriate and most beneficial for them, and it would also focus taxpayer resources on undergraduate degrees and certificate programs. If the four-year time limit for the AOTC is removed as we recommend, many students who are currently only eligible for the Lifetime Learning Credit will be able to claim the AOTC when they return to school to complete their degree later in life. Eliminating the Lifetime Learning Credit would save an estimated $28 billion over 10 years.[221]

  If policymakers want to retain tax benefits for graduate students, we recommend that graduate students be allowed to claim an AOTC of up to $1,000 per year up to the lifetime limit.[222] For example, if a student did not claim the maximum lifetime AOTC benefit for their undergraduate education, the student could claim the remaining amount during graduate school. This would particularly benefit older students who may not have had an opportunity to claim the HOPE Credit or AOTC when they were undergraduates. To maintain simplicity, the same income limits and indexing would apply to AOTCs for undergraduate and graduate education. To target resources to support degree completion and better prevent fraud, graduate students would need to be in a degree program and need to be enrolled at least half time. Of course, making any graduate students eligible for the AOTC would reduce the savings from eliminating the Lifetime Learning Credit.

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[220] Estimate is compared to current tax policy, which includes the tuition and fees deduction. The Treasury Department estimates the cost of the tuition and fees tax deduction as $690 million in 2011. Office of Management and Budget. Analytical Perspectives. Table 17-1. "Estimates Of Total Income Tax Expenditures For Fiscal Years 2011-2017." http://www.whitehouse.gov/sites/default/files/omb/budget/fy2013/assets/teb2013.xls. Note that this estimate would likely be somewhat affected by the ATRA.

[221] The Treasury Department estimates the cost of the Lifetime Learning Credit as $2.8 billion in 2011. Office of Management and Budget. Analytical Perspectives. Table 17-1. "Estimates Of Total Income Tax Expenditures For Fiscal Years 2011-2017." http://www.whitehouse.gov/sites/default/files/omb/budget/fy2013/assets/teb2013.xls. Note that this estimate would likely be somewhat affected by the ATRA.

[222] For graduate education, the AOTC would cover 40 percent of the first $2,000 of qualified expenses and 20 percent of the next $1,000, with the threshold amounts indexed to inflation.

- *Exclusion of earnings from Coverdell savings accounts.*
  Taxpayers with incomes up to $220,000 may make after-tax contributions to an unlimited number of Coverdell savings accounts, in which interest accumulates tax-free and can be withdrawn tax-free if the funds are used for higher education or K-12 tuition, fees, room, or board.[223] This benefit is highly regressive because higher income taxpayers receive the greatest benefit from it and are the most likely to be able to establish a Coverdell account. It is also unnecessary given the generous tax treatment of 529 plans and prepaid tuition plans, and adds unnecessary complexity to the tax code. This benefit should be eliminated immediately for new contributions. If this is not feasible, then at a minimum, the 2001 expansions, which greatly increased the contribution limits and income limits and added savings for K-12 education, should immediately be repealed for new contributions. Eliminating this benefit is projected to save almost $1 billion over the next 10 years, and it will simplify the tax code and make it less regressive.[224]

Stop taxing forgiven or discharged student loans as income.

Current law treats forgiven or discharged student loan balances inconsistently. For example, the discharged amount is not treated as taxable income if the loan is discharged because a school closed before the student could complete the program or transfer, or if the loan is forgiven as a result of a public service loan forgiveness program. In contrast, the discharged loan is considered taxable income if it is discharged because the borrower died or became totally and permanently disabled, or if it is discharged after 20 or 25 years of income-based payments. This has led to confusing messages for borrowers, in which warnings about the taxability of forgiven debt far in the future may discourage those who most need the assurance of affordable payments right now. Treating discharged loan balances as taxable income creates a tax liability that most recipients will be unable to afford.

Discharged student loans should not be treated as taxable income, regardless of the reason for the discharge. Bipartisan legislation introduced in the 111th Congress (H.R. 2492) would eliminate the taxation of loans forgiven under Income-Based Repayment (IBR), Income-Contingent Repayment (ICR), and Pay As You Earn, ensuring true loan forgiveness for responsible borrowers. The bill was cosponsored by 47 Members of Congress from both sides of the aisle and was endorsed by more than 20 organizations and the Obama Administration.[225] Likewise, families whose children have died or become permanently disabled and unable to

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[223] The Economic Growth and Tax Relief Reconciliation Act of 2001 significantly increased annual contribution limits (from $500 to $2,000), increased the income eligibility phase-out range (from $150,000-$160,000 to $190,000-$220,000 for joint filers), and added the ability to use the accounts for K-12 education and to receive both Coverdell distributions and education tax credits in the same year (for different expenses). ATRA made these expansions permanent.

[224] The Treasury Department estimates the cost of the Coverdell exclusion as $70 million in 2011. Office of Management and Budget. Analytical Perspectives. Table 17-1. "Estimates Of Total Income Tax Expenditures For Fiscal Years 2011-2017." http://www.whitehouse.gov/sites/default/files/omb/budget/fy2013/assets/teb2013.xls.

[225] For more information, see http://projectonstudentdebt.org/initiative_view.php?initiative_idx=8.

work should not be hit with a tax bill that could come to thousands of dollars when their loans are discharged.

Stop taxing Pell Grants as income.

To increase fairness, simplify the tax code, and improve coordination with the AOTC, Pell Grants should not be treated as taxable income as long as they are used for a qualified education expense. Under current law, Pell Grants may be used to cover any eligible cost of attendance, including tuition, fees, books, supplies, transportation, housing, or food. However, Pell Grants are *not* taxed as income if they are used to pay for required tuition, fees, books, supplies, or equipment, but they *are* taxed as income if they are used to pay for transportation, food, housing, or other eligible costs of attendance. The Joint Committee on Taxation reports that eliminating the taxation of Pell Grants would cost less than half a million dollars per year.[226] As such, eliminating the taxation of Pell Grants regardless of which expenses the grants cover would have a negligible impact on revenues while significantly simplifying the tax code and the benefit of Pell Grant receipt.

Moreover, this change would help more students with unmet financial need benefit from both Pell Grants and the AOTC. Currently, if students use their Pell Grants to cover fully their tuition, fees, and books, they will have no out-of-pocket qualified expenses for claiming the AOTC. Meanwhile, if students claim the AOTC for tuition, fees, and books paid for out of pocket, and use their Pell Grants to cover remaining costs of attendance, then they may face a tax liability. By removing the threat of any tax liability associated with Pell Grants, this interaction will no longer occur and more students, particularly at low-tuition institutions such as community colleges, will be able to benefit from both Pell Grants and the AOTC, just as students attending higher cost institutions already do. Community college students who receive Pell Grants have an average of more than $5,300 in unmet need after all grants,[227] and non-tuition expenses account for the *majority* of the cost of attending a community college.[228] Thus, by enabling students to use their Pell Grants for eligible non-tuition expenses without fear of negative tax consequences, many more students will be able to use the AOTC to help cover their tuition, fees, and books, and their Pell Grants to help cover other costs of attendance.

Legislation to prevent the taxation of Pell Grants and to better coordinate the AOTC with Pell Grants was introduced by Rep. Danny Davis in 2010 (H.R. 6488). This legislation was endorsed by the Association of Community Colleges, the Association of Community College Trustees, the American Association of State Colleges and Universities, the American Council on Education, the Center on Budget and Policy Priorities, The Education Trust, TICAS, the United States Student Association, and Young Invincibles.

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[226] Joint Committee on Taxation letter to the Honorable Danny K. Davis, July 21, 2010.

[227] Calculations by TICAS on data from the U.S. Department of Education, 2008 National Postsecondary Student Aid Study (NPSAS).

[228] The College Board. 2012. *Trends in College Pricing 2012*. Figure 1. http://trends.collegeboard.org/sites/default/files/college-pricing-2012-full-report_0.pdf.

Better align eligibility for higher education tax benefits with eligibility for student grants and loans.

Federal tax benefits have different eligibility requirements from federal student aid administered by the Department, greatly increasing complexity and reducing their effectiveness. Where possible, their eligibility requirements should be aligned.

In addition to the treatment of transportation and child care costs discussed above, another example of where eligibility for tax benefits should be aligned with the eligibility requirements for federal student aid involves a student's conviction for possessing or selling illegal drugs. If a student is convicted for the possession or sale of illegal drugs while receiving federal student aid from the Department, his or her eligibility for aid is *suspended* for that award year. Such students regain their eligibility in the next school year, or may regain it sooner by successfully completing an approved drug rehabilitation program or by passing two unannounced drug tests administered by an approved drug rehabilitation program. In contrast, students are rendered *permanently* ineligible for the AOTC and HOPE Credit if they have ever been convicted of a felony for possessing or distributing an illegal substance, even if it happened many years earlier when they were a minor or have completed their sentence. A recent study analyzed a similar policy in effect for federal aid from 2001 to 2007, and found it had a significant negative effect on college enrollment.[229] Few, if any, other provisions in the tax code are affected by one's criminal record. The current policy adds to the complexity of the tax code, is at odds with other higher education tax provisions, and is particularly inappropriate in the context of access to education and training needed for students to become productive, taxpaying citizens.

Section 7: Better Information

Students and their families need clear, timely, and comparable information about costs, financial aid, and outcomes to make wise decisions about where to go to college and how to pay for it. As discussed in Section 1, there are substantial differences between colleges' costs and outcomes. However, students currently lack the information they need to best determine which schools to apply to and attend. With easy-to-understand, comparable information, students and families will be able to better identify colleges that provide the best value and fit their specific needs. Increased transparency and awareness may also create pressure for colleges to keep their costs to students affordable and find ways to better support student success.

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[229] Lovenheim, Michael F. and Emily G. Owens. 2013. *Does Federal Financial Aid Affect College Enrollment? Evidence from Drug Offenders and the Higher Education Act of 1998.* National Bureau of Economic Research. Working Paper No. 18749. http://www.nber.org/papers/w18749.pdf.

Additionally, research suggests that we can increase the effectiveness of student financial aid simply by making sure that students are aware of it, what it will mean for them, and how to apply.[230] This means that we can increase the impact of the changes proposed in the previous sections of this paper by providing students and families with meaningful information when they most need it.

To provide students and families with the tools they need, when they need them, we recommend several improvements to increase the availability of relevant data and present that information in a more comparable and consumer-friendly format:

- Provide key data on cumulative student debt, private loan borrowing, loan defaults, and graduation rates.
- Provide comparable and easy-to-understand information about financial aid, costs, and outcomes to students *early* in their college decision process.
- Require all colleges to use a standard format for financial aid award letters.
- Conduct consumer testing to ensure that information is presented in the most effective way.

Provide key data on cumulative student debt, private loan borrowing, loan defaults, and graduation rates.

When deciding whether and where to go to college, students need to know their chances of graduating and their chances of graduating with debt, particularly high debt and/or risky private loan debt. Unfortunately, there are major limitations in the data currently available on student debt and completion.

For example, the U.S. Department of Education (the Department) does not currently collect college-level data on students' debt at graduation. Instead, the Department collects data on annual federal loan borrowing for all undergraduates (how much a college's students borrow in federal loans in a given year), cumulative debt when entering repayment (including students who dropped out as well as those who graduated), and annual federal and private loan borrowing just for first-time, full-time undergraduates.

Furthermore, there are currently no comprehensive college-level data available on private loan borrowing. As discussed in Section 5, private student loans are one of the riskiest ways to pay for college.[231] No more a form of financial aid than a credit card, private student loans typically have interest rates that are highest for those who can least afford them and lack the basic consumer protections and flexible repayment options of federal loans. The most recent available national data indicate that 33 percent of bachelor's degree recipients graduated with private

[230] Long, Bridget T. 2008. *What Is Known About the Impact of Financial Aid? Implications for Policy.* National Center for Postsecondary Research. Working Paper. http://www.eric.ed.gov/PDFS/ED501555.pdf.

[231] For more information, see http://projectonstudentdebt.org/privateloans.vp.html.

loans, with an average private loan amount of $12,550.[232] However, there is great variation in private loan borrowing among individual schools and different types of institutions. For example, private loans are most prevalent at for-profit colleges, where 64 percent of graduating seniors have private loan debt.[233] Improving information on private loans would help inform student decisions about where to go to college as well as illuminate the struggles that these borrowers face, identify areas that need policy attention, and inform future borrowers of the pitfalls of private educational lending.

The Department should immediately begin to collect data on student debt at graduation for all colleges, including both federal *and* private loans, and make those data available to students and borrowers. With minor enhancements to its annual survey of colleges, the Department could quickly begin collecting the average student debt at graduation, the share of that debt that is private loans, and the average annual private loan borrowing at each college that receives federal funding. Ultimately, the best way to provide accurate and comprehensive data, while minimizing the reporting burden for colleges, is for the Department to collect the data directly from lenders, using the system through which lenders currently report on every federal loan they hold. This would enable all borrowers to see all their loans, federal and private, in one place and receive loan counseling based on their total student debt, one of the key recommendations in the recent joint report to Congress by the Department and the Consumer Financial Protection Bureau (CFPB).[234] The CFPB and the Department should work together to improve the collection of private loan data from lenders and provide more accessible and comprehensive loan information to borrowers.

The Department should also begin publishing college-level cohort default rates (CDRs) that capture more of a student's repayment period (e.g., five years). As discussed in Section 3, current CDR measures only track the share of a school's borrowers who default on their federal loans within the first two or three years of repayment. Tracking borrowers for a longer period of time would provide a more comprehensive picture of how successfully students are able to repay their loans after leaving school. This alternative measurement would be for disclosure purposes only, providing information to consumers via tools such as the College Scorecard (discussed below), without compromising the timeliness of the shorter-term CDRs used for assessing a school's eligibility for Title IV funding.

Additionally, we recommend that the Department collect and make widely available college-level data on graduation rates for part-time students, transfer-in students, and Pell Grant

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[232] Calculations by the Project on Student Debt on data from the 2008 National Postsecondary Student Aid Study (NPSAS). Figures reflect the cumulative private (nonfederal) loan debt of bachelor's degree recipients who were U.S. citizens or permanent residents and graduated from a public, private nonprofit, or private for-profit four-year postsecondary institution during the 2007-08 academic year.

[233] Ibid.

[234] Consumer Financial Protection Bureau and U.S. Department of Education. 2012. *Private Student Loans: Report to the Senate Committee on Banking, Housing, and Urban Affairs, the Senate Committee on Health, Education, Labor, and Pensions, the House of Representatives Committee on Financial Services, and the House of Representatives Committee on Education and the Workforce*. http://files.consumerfinance.gov/f/201207_cfpb_Reports_Private-Student-Loans.pdf.

recipients.[235] Currently, the Department only collects data on graduation rates for first-time, full-time students, which represent a small share of entering students at many colleges. Collecting graduation rate data for part-time students and transfer-in students, as recommended by two recent Technical Review Panels for the Department,[236] would significantly increase the percentage of students included in outcome measures. Additionally, to gauge the success rates of low-income students, the Department should collect the graduation rates of Pell Grant recipients and non-recipients. Colleges are currently required to disclose these rates, but a 2011 study found that many public and nonprofit four-year colleges were not providing the required disclosures and even when they did, the information was not in a form that would be useful for students and families.[237]

Provide comparable and easy-to-understand information about financial aid, costs, and outcomes to students early in their college decision process.

The timing of information matters. Improving the availability and quality of data is not helpful if students do not end up seeing that information until many of their major decisions about whether and where to go to college have already been made. To ensure that students and their families receive clear, comparable, and easy-to-understand information at crucial early stages in their college decision process, we recommend providing early estimates of aid eligibility, improving the FAFSA4caster tool, creating and promoting College Scorecards with key information on each college, and making net price calculators easier to find, use, and compare.

Annually notify households of likely financial aid eligibility based on their tax information. Early awareness of aid eligibility can help students and families plan for college, both academically and financially, and encourage them to apply for aid when the time comes. As discussed in Section 1, research has found that many students and families overestimate the cost of college and rule out colleges based on "sticker price" alone, without considering financial aid. Notably, students from lower- and middle-income families were more likely than affluent students to rule out colleges based on published prices.

Waiting for prospective students and their parents to seek out aid information means it may happen too late or not at all. Instead, as the Institute for Higher Education Policy and others have recommended, the Internal Revenue Service (IRS) and Department should work together to *proactively* provide households with annual estimates of federal aid eligibility, similar to the

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[235] For more information about our recommendations for improving data collection of completion measures, see http://projectonstudentdebt.org/files/pub/TICAS_comments_on_TRP37_CMSS_final_05-29-12.pdf.

[236] RTI International. 2012. *Report and Suggestions from IPEDS Technical Review Panel #37: Selected Outcomes of the Advisory Committee on Measures of Student Success.* http://bit.ly/VEHuKt. RTI International. 2012. *Report and Suggestions from IPEDS Technical Review Panel #40. Additional Selected Outcomes of the Advisory Committee on Measures of Student Success.* https://edsurveys.rti.org/IPEDS_TRP/documents%5CTRP40_Suggestions_final.pdf.

[237] The American Enterprise Institute and Education Sector. 2011. *The Truth Behind Higher Education Disclosure Laws.* http://www.aei.org/files/2011/11/07/-truthhighereddisclosurelaws_185621335060.pdf.

Social Security statements Americans receive each year.[228] Available tax information can be used to provide a snapshot of likely aid based on current financial circumstances. The more aid determinations rely on available tax information, as recommended in Section 2, the more robust these annual estimates will be.

For example, households with likely Pell Grant recipients could receive a message like, "If you or your child enrolled in college today, you would likely be eligible for at least $__ in grants, which do not have to be paid back. There are also other forms of financial aid available and it is easy to find out more." Wherever possible, the statements would be customized to include contextual information for the recipient's income range and state of residence, such as the estimated net price of attending the nearest public four-year and two-year colleges (or average net price for public colleges in the state), and how to find out more. The statement would also point to the improved FAFSA4caster (recommended below) for those not yet ready to apply to college, to the online FAFSA for those who are, and to college-level information available on the Administration's planned College Scorecards and on the College Navigator website.[229]

Improve the FAFSA4caster.
For those actively seeking aid estimates (perhaps in response to an annual notice as described above), the FAFSA4caster tool should make the most of available information and be as user-friendly as possible.[230] The FAFSA4caster is the Department's free financial aid calculator intended to provide students with an early estimate of their eligibility for federal financial aid. With practical improvements, it could quickly and easily provide a more refined estimate than the annual notice described above and directly link users to college-specific information. Users should be able to electronically transfer their own tax information into the 4caster, just as they already can when using the online Free Application for Federal Student Aid (FAFSA) and when applying for an income-based payment plan for federal student loans. By combining IRS data with answers to simple questions about the student's age or dependency status, the number of the family's children in college, and – if different from the IRS definition – the family's size, the 4caster will yield a more precise estimate of aid eligibility than one based on tax information alone.

For users who name a college or colleges they are interested in, the improved 4caster would automatically display the cost of attendance rather than requiring the user to look it up separately on College Navigator. It would also prominently display the estimated or average net price, followed by a list of options to cover college costs, link to the relevant College Scorecard or profile on College Navigator, and link to the college's net price calculator. Users who do not specify colleges in the 4caster would receive information on the nearest public four-year and two-year colleges (or averages for public colleges in the state). These changes, particularly if consumer-tested, will help make the 4caster much more useful for prospective students, their parents, college counselors, and others who students and families turn to for advice about college affordability.

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[228] Institute for Higher Education Policy. 2013. Making Sense Of The System: Financial Aid Reform for the 21st Century Student. http://bit.ly/14Kbi5u.

[229] The U.S. Department of Education's College Navigator website is available at http://nces.ed.gov/collegenavigator/.

[230] The current FAFSA4caster is available at http://studentaid.ed.gov/fafsa/estimate.

Create and promote College Scorecards.
The College Scorecards currently being developed by the Administration are one-page forms illustrating the typical costs and student outcomes at each college receiving federal financial aid, compared to other colleges.[241] By presenting a limited set of data in an easy-to-understand format, these scorecards should help students quickly and easily understand their chances of completing, borrowing, graduating with high debt, and defaulting on their loans at a particular college. We support the development of this tool and recommend that the Department move quickly to finalize and promote it. Ultimately, however, our recommended improvements to the collection of data on student borrowing and completion must be made for this tool to provide the most useful information to students and families.

Make net price calculators easier to find, use, and compare.
To help students and families better gauge how much a particular college would cost them and where to apply, all colleges are now required by federal law to post online "net price calculators." These calculators provide early, individualized estimates of net price: the full cost of attendance minus grants and scholarships. This tool is a major step forward if implemented to achieve the goals Congress intended. Unfortunately, our research has found that many of these calculators are buried on college websites, have dozens of complicated questions, or generate estimates that are confusing, misleadingly optimistic, or unnecessarily out-of-date.[242]

Our recent report, *Adding It All Up 2012: Are College Net Price Calculators Easy to Find, Use, and Compare?* includes specific recommendations for colleges and the Department to make net price calculators more user-friendly, so prospective students and their families can make more informed decisions about which colleges to apply to and attend. For example, net price calculators should always:

- Be prominently posted on the financial aid and/or costs sections of college websites.
- Limit the number of detailed financial and academic questions, particularly those that are required, and make clear which questions are really required.
- Make it easy to find federally required estimates of the full cost of attendance, grant aid, and net price. The net price should always be the most prominent figure on the results page.
- Clearly differentiate any "self-help" (loans or student work) from grants and scholarships and limit recommended borrowing to federal student loans.

[241] See a draft version of the College Scorecard at http://www.whitehouse.gov/sites/default/files/image/college-value-profile.pdf.

[242] TICAS. 2012. *Adding It All Up 2012: Are College Net Price Calculators Easy to Find, Use, and Compare?* http://ticas.org/files/pub/Adding_It_All_Up_2012.pdf.

Require all colleges to use a standard format for financial aid award letters.

For the millions of students who receive financial aid each year, award letters represent a crucial point in the long and often confusing financial aid process. For students entering college, this is the first point at which they and their families find out their actual cost of attending specific colleges, as well as each college's recommendations for how to cover that cost. Unfortunately, based on our research of more than 100 actual award letters, we have found that many do not display the full cost of attendance, do not calculate net price, fail to differentiate gift aid from loans or work-study, include confusing acronyms and terminology that are not defined, and inadequately explain deadlines and procedures.[243]

Standardizing the format and elements of award letters would make it much easier for students and families to compare the financial aid packages of different colleges. All award letters should include the following elements: the full cost of attendance at an institution (as defined by federal law), the total amount of grant aid, and the net price remaining after grant aid is subtracted. Grant aid should be clearly separated from self-help (loans and work-study). Award letters should use easy-to-understand language and provide information about required next steps and contact information for the financial aid office. These elements are similar to our recommendations for other consumer products, such as net price calculators, because it is helpful for students and families to see information presented in a consistent way throughout the college decision-making process.

We support bipartisan efforts to require all colleges that receive federal aid to use a standardized format for their award letters.[244] One example of a standardized model is the "financial aid shopping sheet," jointly developed by the Department and the CFPB.[245] This voluntary model format for financial aid offers is intended to make it easier for students and families to understand and compare how much they would need to save, earn or borrow to cover all college costs at each college to which they have been admitted. As of late 2012, more than 500 institutions enrolling 13 percent of all undergraduates have agreed to use the Shopping Sheet in the 2013-14 school year.[246] To allow students to easily compare costs, no matter where they apply, all colleges should be required to use a standard format.

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[243] TICAS. 2011. Public comments to the U.S. Department of Education on financial aid award letters. http://ticas.org/files/pub/TICAS_award_letters_comments_08-25-11.pdf.

[244] For example, see The Understanding the True Cost of College Act of 2012 (S. 3244). Introduced May 24, 2012. http://thomas.loc.gov/cgi-bin/query/z?c112:S.3244:.

[245] The Financial Aid Shopping sheet can be viewed at http://collegecost.ed.gov/shopping_sheet.pdf.

[246] U.S. Department of Education. November 15, 2012. *Homeroom: The Official Blog of the U.S. Department of Education*. November 15, 2012. "More than 500 Colleges Agree to Adopt Financial Aid Shopping Sheet." http://www.ed.gov/blog/2012/11/more-than-500-colleges-agree-to-adopt-financial-aid-shopping-sheet/.

Conduct consumer testing to ensure that information is presented in the most effective way.

Without consumer feedback and testing, well-intentioned efforts to calculate and provide meaningful data can go awry. The Department's recent efforts to define and disclose "on-time completion" rates are a case in point. To help prospective students understand their chances of success, all career education programs are required to disclose their on-time completion rates. However, the Department's current definition of "on-time completion" is problematic because it only includes students who complete the program, rather than all students who started the program. As student and consumer advocates have pointed out, this calculation is misleading and potentially harmful.[247] Testing the disclosures with prospective and current students could have identified the problem as well as more meaningful alternatives.

As this example makes clear, the format, content, and delivery method of all consumer products should undergo rigorous testing with the target population (e.g., students and their families). For the tools, resources, and disclosures discussed throughout this paper, consumer testing should include audiences with little or no college knowledge and experience. Such testing allows developers to evaluate how products are used and understood by the intended beneficiaries. User feedback may reveal a need to streamline or clarify information, provide additional context, or present a different set of data. For instance, focus groups recently held by the Center for American Progress suggested that the draft College Scorecard, discussed earlier in this section, could be improved by simplifying technical language and more clearly identifying its purpose.[248] Consumer testing should always be conducted before products are finalized, as well as to inform continuing improvements.

Appendix: Options to Pay for Recommended Reforms

As a nation, we have the resources to expand college access and increase student success by implementing the recommendations in this white paper, some of which require increased federal investment. For example, to close the projected Pell Grant "funding gap" over the next 10 years will require an estimated $23 billion.[249] Our proposal to significantly increase Pell

[247] For more information, see the 2011 coalition letter urging the U.S. Department of Education to fix the on-time completion rate disclosures: http://ticas.org/files/pub/On-time_completion_rate_letter.pdf.

[248] Center for American Progress. 2012. *Improving the College Scorecard: Using Student Feedback to Create an Effective Disclosure.* http://www.americanprogress.org/wp-content/uploads/2012/11/CollegeScorecard-4.pdf.

[249] Calculations by the Center on Budget and Policy Priorities on data from the Congressional Budget Office (CBO), February 2013 baseline projections for the Pell Grant program, http://cbo.gov/sites/default/files/cbofiles/attachments/43912_PellGrants.pdf. Assumes Congress maintains the FY2012

Grants to restore their purchasing power and better target funds to the students who need them most will require billions more. However, this investment is not only sound, as supported by evidence, but necessary if we are serious about making college affordable for all students willing to study hard so that we can maintain and build an internationally competitive workforce.

Below is a list of common-sense reform options that would more than fully pay for the investments we recommend. Many of these options enjoy bipartisan support and have been endorsed by diverse organizations and economists. Although some have been proposed as ways to reduce the federal budget deficit, they generate enough savings that after offsetting the cost of our proposed policies, the bulk of the savings could still be directed at deficit reduction. This list of options makes clear that our recommended policies could be paid for without increasing the deficit, requiring harmful cuts in effective programs, or requiring increased income tax rates.

Note that all savings cited were estimated prior to enactment of the American Taxpayer Relief Act of 2012 (ATRA) and will be expected to change somewhat, but not dramatically, based on the new law. Also, tax expenditure cost estimates, where cited, are not exact estimates of the federal revenue that would be raised if a provision were eliminated, but provide a good sense of the scale of potential savings.

10-Year Savings	Reform Option
\$580 billion- \$1.2 trillion[250]	**Limit the tax benefit of itemized deductions to 15 percent or 28 percent.**

Currently, the highest income Americans receive the greatest benefit from tax deductions. For example, a \$1,000 tax deduction reduces by \$150 the taxes of a typical middle-income family in the 15 percent tax bracket while the same deduction can reduce the taxes of an individual earning \$1 million a year by more than twice that amount - up to \$396. Members of both parties have endorsed limiting the value of deductions, which would not only raise revenue, but also increase the fairness of our tax code. A diverse range of public interest organizations have called for limiting or eliminating tax deductions, including the Bipartisan Policy Center's *Restoring America's Future*, the National Commission on Fiscal Responsibility's *Moment of Truth*, and the

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discretionary appropriation for Pell Grants in FY2013 and that the Pell discretionary appropriation keeps pace with the Budget Control Act caps starting in FY2014.

[250] The Congressional Budget Office estimates that limiting the value of itemized deductions to 15 percent would raise \$1.2 trillion over 10 years, relative to pre-American Taxpayer Relief Act of 2012 (ATRA) law. Congressional Budget Office. 2011. *Reducing the Deficit: Spending and Revenue Options*. http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/120xx/doc12085/03-10-reducingthedeficit.pdf. Pp. 151-152. The President's proposal to limit the value of itemized deductions to 28 percent would raise \$584 billion during 2013-2022 relative to the Administration's baseline to return tax rates on income above \$250,000 to Clinton-era levels, according to the Treasury Department. Office of Management and Budget. *The President's Budget for Fiscal Year 2013*. "Summary Tables." http://www.whitehouse.gov/sites/default/files/omb/budget/fy2013/assets/tables.pdf. P. 220. Because ATRA raised marginal tax rates for fewer taxpayers than was assumed in either of these estimates' baseline, the proposals would likely raise somewhat less revenue if enacted at current marginal tax rates.

Center for American Progress' *Budgeting for Growth*.[251] President Obama's Fiscal Year 2013 Budget proposed limiting income tax deductions to 28 percent, and Republican presidential candidate Mitt Romney proposed a firm cap of around $35,000, which would generate even greater savings than the President's proposal.[252] Others have proposed capping deductions at $25,000 or $50,000 per year. Another approach would be to phase out high-income taxpayers' personal exemptions and itemized deductions beginning at or below the levels set prior to 2001.

$352 billion[253] Place a small tax on financial securities trades.

The Wall Street Trading and Speculators Tax Act, introduced in 2012 by Senators Harkin, Sanders, Brown, and Whitehouse (S. 1787 and H.R. 3313), would place a small tax of three basis points (three pennies on $100 in value or 0.03%) on the trading of financial securities, including stocks, bonds, and other debt securities, except for their initial issuance. By setting the tax rate very low, the measure is unlikely to impact decisions to engage in productive economic activity. However, it could reduce certain speculative activities like high-speed computer trading. Such a policy is not unprecedented. Prior to 1966, the United States taxed all stock transactions and transfers, and during the Great Depression, Congress doubled the transaction tax rate to finance economic recovery initiatives. Currently, 30 other nations, including the United Kingdom, impose a transaction tax, and in each case the rate is higher than our proposed rate of 0.03 percent. Eleven European Union nations have agreed to move forward with a 10 basis point tax (0.10%). In the United States, this legislation is supported by a wide range of consumer, civil rights, and labor organizations, including Americans for Financial Reform, the Leadership Conference on Civil and Human Rights, Dēmos, and U.S. PIRG.[254]

$71 billion[255] Impose a fee on large financial institutions.

This option would assess an annual fee on large banks, thrifts, brokers, security dealers, and U.S. holding companies that control such entities. The fee would apply only to firms with consolidated assets of more than $50 billion. At 0.15 percent, the Congressional Budget Office (CBO) believes it is unlikely to cause financial institutions to significantly change their financial structure or activities, although it might affect an institution's tendency to take various risks.

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[251] OMB Watch. 2012. *Limit the deductions higher income households can claim on tax returns to 28 percent ($584 billion), or to 15 percent ($1.2 trillion).* http://www.ombwatch.org/files/budget/Revenue/ItemizedDeductions.pdf.

[252] Weisman, Jonathan. November 12, 2012. "Democrats Like a Romney Idea on Income Tax." *The New York Times.* http://www.nytimes.com/2012/11/13/us/politics/democrats-like-a-romney-idea-to-cap-tax-deductions.html.

[253] Joint Committee on Taxation revenue estimate for 2013-2021. Note that this estimate would likely be impacted somewhat by ATRA. For more information, see http://1.usa.gov/11q4wya.

[254] For more information, see http://ourfinancialsecurity.org/blogs/wp-content/ourfinancialsecurity.org/uploads/2012/12/Summary-of-S.-1787.pdf.

[255] Congressional Budget Office. 2011. *Reducing the Deficit: Spending and Revenue Options.* http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/120xx/doc12085/03-10-reducingthedeficit.pdf. Pp. 201-202.

$60 billion[256] Increase alcohol taxes.

When adjusted for inflation, current excise tax rates on alcoholic beverages are at historically low levels. In the 1950s, excise taxes accounted for nearly half of the pretax price of alcohol; they now account for between 10 percent and 20 percent of the pretax price. The CBO estimates that taxing all types of alcohol at $16 per proof gallon would raise billions in new revenue by increasing the federal excise tax on a 750-milliliter bottle of distilled spirits by $0.40 (from about $2.14 to $2.54 per bottle), a six-pack of beer by $0.48 (from about 33 cents to 81 cents), and a 750-milliliter bottle of wine by $0.49 (from about 21 cents to 70 cents). As highlighted by the CBO, a study conducted for the National Institute on Alcohol Abuse and Alcoholism estimated that the external economic costs of alcohol abuse in the United States exceeded $100 billion in 1998—greatly exceeding the revenues from alcohol taxes. Research has consistently shown that higher prices lead to less alcohol consumption, even among heavy drinkers.

At least $42 billion[257] Reform crop insurance.

Organizations as diverse as the Heritage Foundation and Environmental Working Group have criticized the nation's crop insurance program for wasting taxpayer dollars and primarily benefiting insurance companies and large farmers who do not need assistance. Program costs are expected to hit record levels this year, at the same time that farmers' net incomes are expected to be the second highest in 30 years.[258] Bipartisan legislation, the Crop Insurance Subsidy Reform Act of 2012 (H.R. 6098), would reduce crop insurance premium subsidies to the levels set before the Agriculture Risk Protection Act of 2000, saving an estimated $42 billion over 10 years. This legislation has been endorsed by both taxpayer and environmental groups, including Taxpayers for Common Sense, the Environmental Working Group, Council for Citizens Against Government Waste, Americans for Tax Reform, the Taxpayers Protection Alliance, and the National Taxpayers Union. President Obama also has proposed cutting crop insurance subsidies and reducing the amount paid to insurance companies. However, his more modest reforms are expected to save only $4 billion over 10 years.[259]

Up to $172 billion[260] End orders for obsolete spare parts and improve contracting and financial management at the Defense Department.

Based on Government Accountability Office analyses, the Defense Logistics Agency, Army, Navy, and Air Force have been wasting billions of dollars purchasing items that go unused or

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[256] Congressional Budget Office. 2011. *Reducing the Deficit: Spending and Revenue Options.* http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/120xx/doc12085/03-10-reducingthedeficit.pdf. Pp. 193-194.

[257] Environmental Working Group. 2012. *Impact of Scaling Back Crop Insurance Premium Subsidies.* http://static.ewg.org/pdf/babcock_cropinsurancesubsidies.pdf.

[258] Nixon, Ron. January 15, 2013. "Record Taxpayer Cost Is Seen for Crop Insurance." *The New York Times.* http://www.nytimes.com/2013/01/16/us/politics/record-taxpayer-cost-is-seen-for-crop-insurance.html?_r=0.

[259] Ibid.

[260] U.S. PIRG and National Taxpayers Union. 2011. *Toward Common Ground: Bridging the Political Divide with Deficit Reduction Recommendations for the Super Committee.* http://www.uspirg.org/sites/pirg/files/reports/USPIRG_Toward_Common_Ground.pdf.

were never required (as much as 50% more than required). According to a report by the U.S. PIRG and National Taxpayers Union, eliminating orders for obsolete spare parts and supplies would save nearly $37 billion over the next 10 years, and implementing acquisition reforms identified by the bipartisan Defense Acquisition Panel would save up to an additional $135 billion.

Up to $37 billion[251] Eliminate or reform tax-exempt bonds for private nonprofit colleges and universities.

The organization Young Invincibles recently recommended eliminating or reforming the tax-exempt bonds for private educational institutions because they provide a windfall to high-income bond purchasers. Private nonprofit colleges and universities issue tax-exempt bonds, called "qualified 501(c)(3) bonds," to raise capital for building construction or repay previously issued bonds.

$21 billion[252] Tax private equity and hedge fund income like other income.

Many private-equity and hedge fund managers receive the bulk of their income through "carried interest," which is currently taxed at a maximum rate of 20 percent, rather than as income, which is taxed at a progressive rate up to 39.6 percent for those with the highest incomes. Taxing carried interest as income would increase both tax fairness and revenue. Income that partners received as a return on their own capital contribution would not be affected. Legislation to tax carried interest as income has passed the House of Representatives three times and has been repeatedly included in the Obama Administration's budget proposals.

$17 billion[253] Reduce federal student loan costs through Direct Loan consolidation.

The New America Foundation has proposed creating a permanent federal student loan consolidation program that would enable borrowers with bank-based federal student loans, made under the Federal Family Education Loan (FFEL) program, to consolidate them into the more efficient Direct Loan program. Because Direct Loans save taxpayers money compared to FFEL Loans, borrowers could be offered an interest rate reduction as an incentive to consolidate, lowering the cost to borrowers and saving taxpayers an estimated $17 billion.

Up to $20 billion[254] Eliminate or phase out the student loan interest deduction.

As discussed in Section 6, the student loan interest deduction is poorly targeted and timed, providing the greatest tax benefits to those with the highest incomes, years after they have left

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[251] Estimate based on Young Invincibles. 2012. *The Student Perspective on Federal Financial Aid Reform.* http://younginvincibles.org/wp-content/uploads/2012/11/Final-White-Paper-All-Edits.pdf. This estimate would likely be affected by ATRA.

[252] Congressional Budget Office. 2011. *Reducing the Deficit: Spending and Revenue Options.* http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/120xx/doc12085/03-10-reducingthedeficit.pdf. Pp. 157-158. Note that ATRA would be expected to reduce this estimate somewhat.

[253] New America Foundation. 2013. *Rebalancing Resources and Incentives in Federal Student Aid.* http://bit.ly/VxXyS4. P. 15

[254] Ibid. P. 29.

school. In addition, the deduction undermines the targeting of benefits in the Income-Based Repayment (IBR) and related federal student loan repayment programs because they are based on a borrower's Adjusted Gross Income (AGI), which is reduced by the student loan deduction. Eliminating the deduction immediately would save up to $20 billion over 10 years.

$7 billion[245] **Repeal the tuition and fees tax deduction.**

As discussed in Section 6, the tuition and fees deduction is also poorly targeted and is unnecessary given the expansion of the American Opportunity Tax Credit (AOTC). It also adds significant unneeded complexity to the tax code because taxpayers cannot take both the AOTC and the deduction in the same year, and the AOTC is per student while the deduction is per tax return. This deduction was extended through the end of 2013 and should be allowed to expire at that time.

$28 billion[246] **Repeal the Lifetime Learning Credit.**

As discussed in Section 6, the $2.8 billion invested per year in the Lifetime Learning Credit would have a greater impact on college enrollment and would be better targeted if it were invested in Pell Grants or the AOTC. Unlike the AOTC, the Lifetime Learning Credit can be used for graduate degree programs. If there is a need to provide a tax credit to offset the cost of graduate education, it would be simpler and better targeted to provide a limited AOTC for graduate education than to maintain a separate tax credit with different eligibility and income limits. In contrast to the AOTC, which is per student, the Lifetime Learning Credit is per tax return, further adding to the complexity of offering both credits.

$3 billion[247] **Reduce loan rehabilitation fees and funds retained by guaranty agencies.**

When guaranty agencies rehabilitate a defaulted federal student loan made under the Federal Family Education Loan (FFEL) program, they currently are compensated a substantial amount. When a FFEL loan is successfully rehabilitated, the guaranty agency sells the loan to a FFEL lender. The agency must then remit those funds to the federal government. However, they are able to retain 37 percent of the original defaulted loan amount as compensation, and half of that total (18.5%) is charged to the borrower's account as a collection fee. Eliminating the guaranty agencies' retention portion and requiring them to remit the entire balance to the U.S. Department of Education (the Department) will save taxpayers more than $3 billion. Furthermore, reducing the collection fee to 16 percent would significantly reduce the perverse

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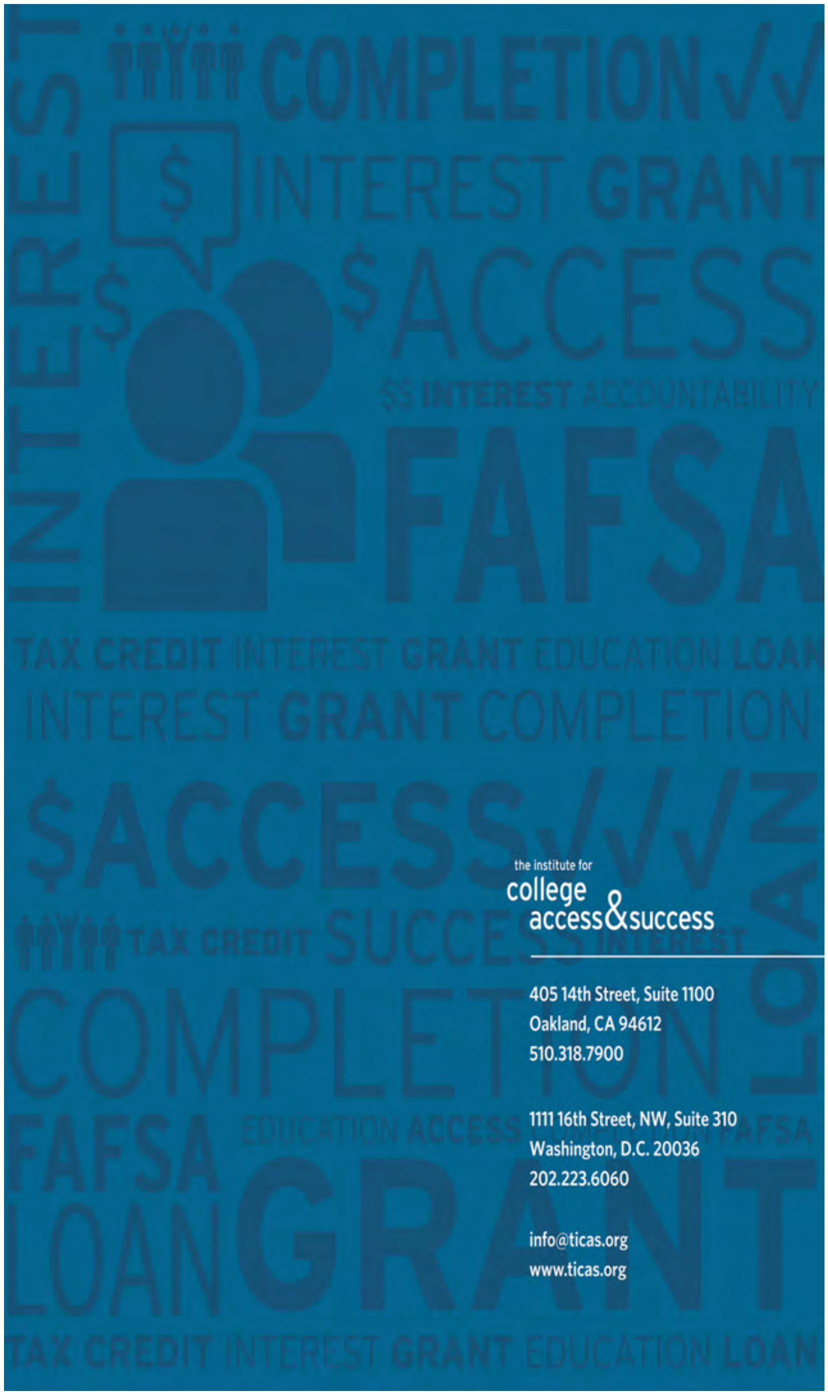
[245] Estimate is compared to current tax policy, which includes the tuition and fees deduction. The Treasury Department estimates the cost of the tuition and fees tax deduction as $690 million in 2011. Office of Management and Budget. 2012. *The President's Budget for Fiscal Year 2013.* Table 17-1: "Estimates Of Total Income Tax Expenditures For Fiscal Years 2011-2017." http://www.whitehouse.gov/sites/default/files/omb/budget/fy2013/assets/teb2013.xls. This estimate would likely be affected by ATRA.

[246] The Treasury Department estimates the cost of the Lifetime Learning Credit as $2.8 billion in 2011. Office of Management and Budget. 2012. *The President's Budget for Fiscal Year 2013.* Table 17-1; "Estimates Of Total Income Tax Expenditures For Fiscal Years 2011-2017." http://www.whitehouse.gov/sites/default/files/omb/budget/fy2013/assets/teb2013.xls. This estimate would likely be affected by ATRA.

[247] Congressional Budget Office. 2012. *Preliminary estimate of mandatory changes in the Senate FY13 Labor-HHS-Education Appropriations Bill.*

incentive of rewarding lenders for default and rehabilitation as opposed to default prevention. It would also make loan rehabilitation more manageable for borrowers. This proposal was included in the President's Fiscal Year 2013 budget and the Senate's Fiscal Year 2013 Labor, Health and Human Resources, and Education appropriations bill. Both use the savings to fund Pell Grants.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STATEMENT SUBMITTED BY THE CENTER FOR RESPONSIBLE LENDING

Comment for the Record
Hearing on Financial Products for Students: Issues and Challenges
Maura Dundon and Leslie Parrish[1]
Center for Responsible Lending
August 1, 2014

The Center for Responsible Lending (CRL) is pleased to provide a comment for the record on some of the issues covered in the Senate Banking Committee's hearing, "Financial Products for Students: Issues and Challenges" held on July 31, 2014. Students must make important choices related to how much they borrow and from what source, as well as how to conduct every day financial transactions and receive financial aid funds. In addition, standards should be enacted to ensure borrowers' loans are serviced in a fair and appropriate manner, and to safeguard a borrower's ability to seek redress when wronged. We detail our concerns related to these issues, and recommendations to protect students from predatory and unfair practices, in the sections below.

1. **PRIVATE STUDENT LOANS**

Still Risky for Legacy Subprime Borrowers, For-Profit College Students, and Servicemembers

Private student loans should be closely monitored by Congress and regulators. Although origination practices by some lenders do appear to have improved in recent years, the private student lending market historically engaged in lending with risky underwriting standards. Current practices, especially at for-profit colleges, may still place borrowers at risk.[2]

Many borrowers are still struggling today with the consequences of subprime private student loans. Spurred by an expanding market for asset-backed securities, private student lending grew rapidly in the early- to mid-2000s.[3] Just as with mortgages, credit standards weakened and lenders made increasingly aggressive loans. Many borrowers ended up with high, variable rate loans, when they could have chosen much safer federal loans. This resulted in defaults with far-reaching harmful consequences for borrowers, who are usually unable to discharge this type of loan in bankruptcy.

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[1] Maura Dundon is Senior Policy Council and Leslie Parrish is Deputy Director of Research.
[2] *See* Consumer Financial Protection Bureau, *Private Student Loans* (Aug. 29, 2012), http://www.consumerfinance.gov/reports/private-student-loans-report/ [hereinafter *CFPB Private Student Loan Report*].
[3] *Id.*

Private student loans are especially risky for for-profit college students.[4] This risk stems from the intrinsic features of the loan product (e.g., high, variable rates, and the lack of bankruptcy protection for most borrowers); deceptive practices when originating the loans (e.g., false claims about the school's job placement rate); and the low value of the education and high drop-out rates, which can negate the return on a student's loan investment. Since students of color enroll disproportionately in for-profit colleges, these financial practices also impact them disproportionately.[5]

As the Consumer Financial Protection Bureau (CFPB)'s recent complaint against ITT illustrates, banks partnered with for-profit colleges to offer students abusive private student loans that they know they would never be able to repay.[6] The Senate Committee on Health, Education, Labor and Pensions report on for-profit colleges also details the harmful private student loans made to for-profit college students, some with the cooperation of financial institutions.[7]

In addition to for-profit college students, servicemembers have also been vulnerable to private student loan problems. As demonstrated by the recent enforcement actions by the Department of Justice and FDIC against Sallie Mae Bank and Navient, Sallie Mae's servicing spin-off, private student loan owners and servicers have failed to ensure that active-duty servicemembers receive the benefits due to them under the Servicemembers Civil Relief Act, and have engaged in other unfair practices.[8]

School Certification Needed to Ensure Borrowers Exhaust Federal Loans

Although some students may appropriately use private student loans, private loans lack essential consumer protection features of federal student loans – namely, relief for distressed borrowers. For this reason, most borrowers should exhaust their federal options before turning to private loans. But over half (54%) of private student loan borrowers fail to exhaust their Stafford loan options first.[9] Improved loan counseling practices by schools, as well as improved federal school

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[4] *See* National Consumer Law Center, *Piling It On* (Jan. 2011), http://www.studentloanborrowerassistance.org/wp-content/uploads/2013/05/proprietary-schools-loans.pdf.

[5] *See* Leslie Parrish and Peter Smith, *For-Profit Colleges Saddle African-American and Latino Students with Crushing Debt and Poor Employment Prospects*, Center for Responsible Lending, http://www.responsiblelending.org/student-loans/research-policy/2014-CRL-Policy-Brief-For-Profit-Colleges-and-Students-of-Color-Summary-April.pdf.

[6] *See CFPB v. ITT*, No. 14-292 (S.D. Ind. filed Feb. 26, 2014), http://files.consumerfinance.gov/f/201402_cfpb_complaint_ITT.pdf; *see also*

[7] *See* Senate HELP Committee, *For Profit Higher Education: The Failure to Safeguard the Federal Investment and Ensure Student Success* (Jul. 30, 2012), http://www.help.senate.gov/imo/media/for_profit_report/Contents.pdf (click on chapters about individual schools to read details on private student loans).

[8] *See* Statement of Holly Petraeus, Consumer Financial Bureau (May 13, 2014), http://www.consumerfinance.gov/newsroom/statement-by-cfpbs-holly-petraeus-on-doj-fdic-enforcement-actions-against-sallie-mae/.

[9] *CFPB Private Student Loan Report, supra note TK*, at 10, 50-51.

certification requirements, could help ensure that students chose the best option for their financial situation.

Relief to Struggling Borrowers

Borrowers struggling to repay private student loans, particularly those originated under abusive standards, deserve a comprehensive package of relief. This includes a restoration of bankruptcy rights, which is a crucial backstop of consumer protection; increased refinancing options; enforcement actions by federal and state authorities to obtain restitution where appropriate; and protection against "robosigning" and other illegal debt collection practices.

Refinancing Federal Loans into Private Loans

Some financial institutions are currently refinancing federal student loans into private student loans, or have expressed interest in potentially doing so in the future. But refinancing a federal loan into a private loan would expose some consumers to higher risk, since they would lose their rights to federal income-based repayment plans and to rehabilitate defaulted loans. We are unaware of any private lender who contractually guarantees access to equivalent relief options. Thus, even if consumers receive an interest rate reduction via refinancing, refinancing into a private loan may in some cases leave them worse off. These emerging loan products should be developed and monitored with caution to ensure that only those borrowers who can truly benefit from refinancing out of federal loans receive such loans.

2. SERVICING

Student loan servicers can play an essential role in helping to prevent default. By identifying and counseling distressed borrowers, servicers can help enroll them in appropriate repayment plans before they default. Preventing default benefits the borrower, who avoids a negative credit report, and it also benefits the taxpayer, who continues to receive some payment on the loan.

We appreciate the recent efforts of the White House and Department of Education to reach out to distressed borrowers to enroll them into repayment plans.[10] But stronger and more decisive measures are needed. As long as servicing is outsourced to contractors, the Department of Education must draft and administer contracts in a way that achieves the goal of responsive and fair servicing.

Student loan servicing (both federal and private) should also conform to the high standards of consumer protection and customer service so that borrowers can responsibly manage their obligations. Servicers must provide easy, online access to account information and payment history. They must allow consumers to easily designate how to apply additional payments in

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[10] *See, e.g.,* Fact Sheet: Making College Affordable (Jun. 9, 2014), http://www.whitehouse.gov/the-press-office/2014/06/09/factsheet-making-student-loans-more-affordable.

order to minimize interest and fees, or to facilitate repaying their loans more quickly if they desire.

Finally, servicers must refrain from engaging in unfair and deceptive practices. For example, the FDIC sanctioned Sallie Mae Bank and Navient for applying payments in a way that maximized late fees.[11]

3. ARBITRATION

Forced arbitration clauses with class action bans are a common feature of consumer financial products, including private student loans.[12] These clauses in some cases purport to extend to the student loan servicer as well, even though the borrower never entered into a contract with the servicer.[13] Arbitration and class action bans serve to dampen consumers' ability to obtain redress and reform abusive practices. They compound the harm faced by students with predatory loans or faced with other illegal or unfair practices, especially servicemembers and for-profit college students. Accordingly, Congress and regulators should restrict the use of arbitration agreements in student loans and student loan servicing.

4. PARTNERSHIPS TO OFFER BANK ACCOUNTS AND/OR DEBIT CARDS

Schools often partner with financial institutions to offer bank accounts or prepaid debit cards as a way to facilitate students' receipt of financial aid funds and need to conduct everyday transactions. A recent study by US PIRG found that almost 900 of these partnerships exist, affecting over 9 million students.[14]

Unfortunately, even though schools may provide an implicit endorsement of these products by allowing co-branding, on-campus marketing, or other activities, the CFPB has concluded that these accounts do not have better features than accounts readily available in the broader marketplace.[15] For example, many of these accounts come with unique fees, such as a fee for a debit PIN transaction, or include abusive overdraft features, such as the ability to overdraw an account through a debit card transaction that could simply be declined for no fee; multiple and sustained overdraft fees; and the re-ordering of transactions to artificially generate more overdrafts. CRL's overdraft research has found that young adults are particularly vulnerable to

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[11] *See In the Matter of Sallie Mae Bank*, FDIC-13-0366b and 13-0367k (May 13, 2014), https://www5.fdic.gov/EDOBlob/Mediator.aspx?UniqueID=5007e0b4-911a-435c-9a0a-9d984ec5f53f.

[12] Public Citizen, *Between a Rock and a Hard Place: Courthouse Doors Shut for Aggrieved Private Student Loan Borrowers* (Jul. 2012), http://www.citizen.org/documents/private-student-loans-predatory-lending-arbitration-report.pdf.

[13] *See, e.g., Fensterstock v. Education Finance Partners,* 2012 WL 3930647 (S.D.N.Y. Aug. 30, 2012).

[14] U.S. PIRG, *The Campus Debit Card Trap: Are Bank Partnerships Fair to Students?* (May 2012), http://www.uspirg.org/sites/pirg/files/reports/thecampusdebitcardtrap_may2012_uspef.pdf.

[15] Consumer Financial Protection Bureau, *Perspectives on Financial Products Marketed to Students*, (March 26, 2014), http://files.consumerfinance.gov/f/201403_cfpb_presentation-to-department-education-rulemaking-committee.pdf.

accruing high overdraft fees generated by small, frequent debit card transactions.[16] Similarly, an FDIC study found that young adults were more likely to incur overdraft fees than accountholders generally.[17] These features are especially problematic since schools often enter into revenue sharing agreements with banks, creating a potential conflict of interest between doing what is in their students' best financial interest or maximizing the income generated from the students' adoption and use of these products.

Similar issues related to steering students to certain loans or credit cards have been addressed in the past; Congress and regulators now need to take action to also ensure students are not improperly steered into sponsored checking accounts or debit cards. In the case of financial aid disbursements, students should be encouraged to have funds directly deposited into their existing checking account, and any alternative account or debit card facilitated by the school should be presented in a neutral manner. Sponsored accounts marketed to students should be free of abusive features such as overdraft fees assessed on debit card and ATM transactions that could otherwise be declined at no cost. While some may argue that incorporating basic consumer protections into these accounts may mean that they are no longer attractive for a bank to offer (thus causing students to turn to expensive check cashers for their transaction needs), a CFPB analysis found that less than 0.5% of all students would be unable to secure their own checking account if a sponsored account was unavailable.[18]

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[16] *See* Center for Responsible Lending, *High-Cost Overdraft Practices* (July 2013), http://www.responsiblelending.org/state-of-lending/reports/8-Overdrafts.pdf.

[17] Federal Deposit Insurance Corporation, *FDIC Study of Bank Overdraft Programs* (November 2008), http://www.fdic.gov/bank/analytical/overdraft/FDIC138_ExecutiveSummary_v508.pdf.

[18] Consumer Financial Protection Bureau, *Perspectives on Financial Products Marketed to Students*, (March 26, 2014), http://files.consumerfinance.gov/f/201403_cfpb_presentation-to-department-education-rulemaking-committee.pdf.

STATEMENT SUBMITTED BY THE AMERICAN BANKERS ASSOCIATION

July 31, 2014

Statement for the Record

On behalf of the

American Bankers Association

before the

Committee on Banking, Housing, and Urban Affairs

of the

United States Senate

American
Bankers
Association

Statement for the Record

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July 31, 2014

Chairman Johnson, Ranking Member Crapo, and members of the Committee, ABA appreciates the opportunity to submit comments for the record on the availability of financial products for students. The ABA is the voice of the nation's $14 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard $11 trillion in deposits and extend nearly $8 trillion in loans.

Banks provide an array of products and services for students. Banks provide student loans, but that product was dramatically reduced due to onerous requirements on private lenders following the enactment of the Health Care and Education Reconciliation Act of 2010. The federal government now has the majority stake in student loan underwriting and, since 2010, the growth of student loans provided by the government has skyrocketed, rising over $100 billion annually. Private sector loans make up only 8% of the volume of student loans. Banks also provide checking accounts (usually with a debit card), direct deposit, convenience ATM and branch locations, bill payment options, and stored value and credit cards.

Banks are committed to ensuring students have safe, convenient, and affordable access to banking services so they can buy books and pay their living expenses. Access to banking services—at such a critical point in life—is essential to the long-term financial health of America's students. Many students open their first bank account when they reach college. It is often a landmark event that brings a student into the banking system, promotes financial literacy and develops saving habits that will help them reach their long-term goals.

The costs of providing account services to students is high and the revenue low as most accounts have low account balances and few transactions . Instead, banks offer services to students—often at a loss—in an effort to build a financial relationship with students that someday will include more sophisticated products such as mortgages, college savings, investments and other services. The relationship formed with young adults helps to establish long-term banking relationships. Treating students right is the only way banks can keep customers for life.

We are very concerned about the Department of Education's (DoE) proposal that was the subject of a recent negotiated rulemaking process ("proposal"). First, we believe that DoE has no authority to implement this proposal as a regulation given the plain text of the statute, the legislative history of the provision, and the comprehensive regulatory scheme already in place. Second, if the DoE concept is adopted, significant new regulations, burdens, and restrictions will be placed on any bank account that is the subject of a partnership between a bank (or credit union) and an educational institution. The result will be a discontinuation of accounts tailored to and beneficial to students, whether or not the account receives student loan aid balances. Although the DoE's Proposal seeks to ensure students have access to banking options, it will instead limit their access, harming students and educational institutions alike. Already, it is estimated that as many as 19 percent of college students in the United States have no access to banking services. The DoE proposal would likely make that number much higher.

Make no mistake: it is students who will bear the brunt of the Department of Education's rulemaking. Students will find it harder to secure affordable, convenient bank accounts and services tailored to their needs, often including an on-campus presence. Students who come from families that do not have a bank account or any banking relationship may struggle with how to go about even opening an account. Without these options, many students will be compelled to turn to loosely regulated, less secure, less convenient, and more costly options.

DoE's proposal will also negatively impact educational institutions. Banks have long partnered with educational institutions to offer financial services to students. The revenue received by educational institutions helps to offset tuition and other costs. The DoE proposal would make these arrangements less likely, reduce revenue for these schools, and tie schools up with unnecessary red-tape—all of which would make the cost of attending these schools by students higher than it has to be.

In our statement we will make the following points:

- The Department of Education Proposal will severely limit banks' ability to serve students, meaning fewer services will be available;
- Banks partner with educational institutions to offer services that benefit students; and

- Educational institutions will bear a heavy cost.

I. The Department of Education Proposal will Severely Limit Banks' Ability to Serve Students, Meaning Fewer Services Will Be Available to Students

There are very real costs in offering a checking account. The banks cost to open an account was estimated to be between $150 and $200 and between $250 and $300 annually to maintain it.[1] These costs have only increased since 2010. Balances on student accounts tend to be low and transactions are often limited. As a result banks earn little return on these accounts. These accounts often end up losing money for the bank, but are nonetheless offered to meet the needs of students and develop life-long relationships that continue long after graduation.

Currently, banks partner with educational institutions to provided students no-cost and low-cost services and products. Typically, the accounts have no minimum balance requirements and waive monthly fees. They usually include a free university ID card that also serves as a debit card. Students have choice and are not obligated to open an account. Some banks also fund financial literacy courses or events. Unfortunately, the DoE's proposal in effect would regulate bank accounts by imposing significant requirements and restrictions on all accounts that are part of a bank and educational institution partnership –whether or not the student is receiving federal student loan credit balances. Simply put, the DoE would be regulating bank accounts independent of any relationship with federal student loan credit balances.

The requirements in the DoE proposal would greatly increase the net cost of opening these accounts on a prohibitive basis. The proposal would impose significant requirements and restrictions on bank accounts of students and parents ***eligible*** to receive student aid balances. Thus, the broad proposal affects ***any*** covered bank account whether or not it receives any student aid balances.

The DoE requirements are designed to give away valuable bank account services for free while the bank bears the full cost—including new regulatory requirements—of providing these accounts. The significant costs of these added requirements and regulatory burdens will mean fewer of these accounts will be offered. It also means that the attractive accounts already offered under existing

[1] Dan Fitzpatrick & Robin Sidel, *End Is Seen to Free Checking*, Wall Street Journal, June 16, 2010.

programs would be jettisoned (since they could not be offered by partnering with the school) and students would have to seek out an account that may not be as tailored to their needs as students as the ones currently offered.

In addition to the new requirements imposed on financial institutions, there are also requirements placed on the educational institutions in relation to these sponsored accounts. The educational institutions must:

- Base their decision to partner with a bank on the interests of the account holders. This includes financial terms, account features, and customer service.
- Review any information that is provided to the account holder when the account is opened to ensure that it is clear, fact-based, and neutral.
- Disclose on their site links to all sponsored accounts, accompanied by a summary of terms and conditions of the contract.

Educational institutions already are sensitive to these issues and handle them in different ways depending upon the particular accounts they sponsor and their student needs. Imposing a rigid framework adds additional and unnecessary costs.

Instead of helping students, these onerous requirements will result in the opposite of their intention. There will be fewer, if any, specialized accounts offered to students and parents, whether they are seeking financial aid or not.

II. Banks Partner With Educational Institutions to Offer Services that Benefit Students

Access to safe, secure banking services is critical to students' academic success and long-term financial wellbeing. Many students sign up for their first bank account when they arrive at college. Hundreds of colleges and universities have long standing agreements—both formal and informal—with banks to offer convenient, affordable, and secure banking services to their students. As noted above, typically, the agreements include a specially designed free checking account with a debit card (possibly co-branded with the college) that can also serve as a college ID card. The students have the clear option for a traditional ID card instead. The students with the account also have access to free on-campus ATMs and possibly a banking center. Often part of this package is financial literacy education. If students lose access to these tailored options they will be forced to do without an account or seek other accounts that may not offer services that students value most.

Students have a choice in what bank to use. There is no mandate to use any campus related checking account. Moreover, there are already clear and transparent disclosures provided to the students. The fact is many students opt for these accounts because they are tailored to their needs. They provide convenient access to secure banking services on campus. It also facilitates transactions with local businesses who accept payment with their college ID card. This DoE proposal would directly limit the financial autonomy of students, and prevent them from individually pursuing the options that best suit them.

Students who arrive on campus without a checking account will have to open an account somewhere else or simply go without one. At best, a student will have to find a traditional bank account from an area bank (which may not be tailored to students and may lack some of the convenient features like on-campus ATMs and links to the college ID). In fact the GAO in February 2014 noted that: "Most of the college card fees we reviewed generally were not higher, or in some cases were lower, than those associated with a selection of basic or student checking accounts." At worst, students may not establish a bank account, have to receive financial aid disbursements by check, and use costly check cashing services. Cashing and storing large loan checks involves risks that simply are unacceptable.

Students from traditionally unbanked demographics will be hit hardest. Restricting financial services offerings to students who are eligible for financial aid will disproportionately harm those students with the greatest need. Students receiving financial aid may come from families with little or no banking relationships. They may not understand the value of a bank account, are perhaps the most in need of financial education, and may not seek out off-campus banks to set up accounts. The goal should be to encourage all students to establish a banking relationship. By discouraging bank accounts in partnership with educational institutions, the DoE proposal makes this goal much harder to achieve—to the disadvantage of students.

III. Educational Institutions Will Bear a Heavy Cost As Well

Students will not be the only ones to suffer if the DoE proposal is adopted. Educational institutions will lose access to valuable programs which provide revenue to help offset expenses and keep tuition and other costs as low as possible. These schools will also be subject to new regulatory burdens which also absorb resources. The end result will be to increase the costs at these schools which will result in higher tuitions—paid for by all students.

Educational institutions already choose which options are right for their students. There are generally competing banks offering account services enabling the school to find the best fit. Educational institutions are able to leverage these relationships to provide financial literacy programs for students, faculty, and staff. They are also able to leverage these relationships to build campus infrastructure, ensuring a network of ATMs and sometimes branches on campus. Funds provided by these relationships also fund scholarships, endowments and infrastructure that would otherwise be unavailable.

The DoE's conceptual proposal would place tremendous burdens on educational institutions that choose to partner with a bank. Banking regulations are complex, and require substantial specialized knowledge to comply with them all. The proposal would place the burden of ensuring compliance on the educational institution. Managing banking regulations is a monumental task even for banks accustomed to complicated banking regulations. In contrast, educational institutions, whose staff has no experience in banking regulations, stand little chance of being able to comprehend and comply with complex bank account regulation.

Conclusion

Having convenient, inexpensive and secure bank accounts are extremely important for students. These are often the very first accounts for these students. Banks are dedicated to providing these services as they know it will establish a long-term banking relationship with the students. Banks can only be successful in building and maintaining those relationship if they treat the students right and provide the services that they need. Educational institutions also benefit from these services, providing revenue that keeps student costs as low as possible.

ABA shares the goals of promoting financial education among students and ensuring that they have meaningful account choices. However, the Department of Education's proposal goes beyond its authority and will curtail campus banking products and unduly restrict the manner in which banks can serve students—ultimately hurting student access to safe and convenient banking services. Congress should stop the Department of Education from implementing this harmful rule that will hurt student access to affordable, safe, and reliable financial services.