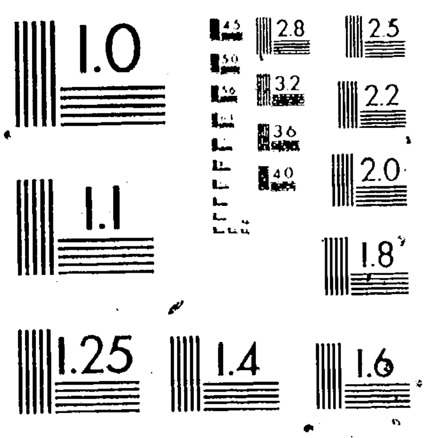

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ABSTRACT

California's participation in Guaranteed Student Loan (GSL) programs are examined. Attention is directed to: the history of federal involvement in student loan programs; California's past and current involvement in federal programs; a profile of California student borrowers; and increasingly high levels of student debt and default rates under the GSL program. The objectives of the federal GSL program are to reduce financial barriers to access into postsecondary education, and to reduce financial barriers to students' choice of colleges. Since its inception in 1966, over 21 million loans totaling $35 billion have made postsecondary education possible for many students. In California, since April 1980, the GSL program has made 750,000 loans totaling $2 billion. Despite concerns about potentially high student debt levels and default rates, the California program appears to be meeting the goals of access and choice. In addition to the profile of financial aid applicants and recipients, data are included on: annual and cumulative loan volume and amount for GSL programs; federal student aid appropriations for major programs; loans guaranteed by educational segment for the California GSL program, 1981-1983. A glossary of major terms associated with the GSL program is appended. (SW)

The California Postsecondary Education Commission was created by the Legislature and the Governor in 1974 as the successor to the California Coordinating Council for Higher Education in order to coordinate and plan for education in California beyond high school. As a state agency, the Commission is responsible for assuring that the State's resources for postsecondary education are utilized effectively and efficiently; for promoting diversity, innovation, and responsiveness to the needs of students and society; and for advising the Legislature and the Governor on statewide educational policy and funding.

The Commission consists of 15 members. Nine represent the general public, with three each appointed by the Speaker of the Assembly, the Senate Rules Committee, and the Governor. The other six represent the major educational systems of the State.

The Commission holds regular public meetings throughout the year at which it takes action on staff studies and adopts positions on legislative proposals affecting postsecondary education. Further information about the Commission, its meetings, its staff, and its other publications may be obtained from the Commission offices at 1020 Twelfth Street, Sacramento, California 95814; telephone (916) 445-7933.

CALIFORNIA'S PARTICIPATION IN GUARANTEED STUDENT LOAN PROGRAMS

POSTSECONDARY EDUCATION CALIFORNIA COMMISSION

CALIFORNIA POSTSECONDARY EDUCATION COMMISSION

1020 TWELFTH STREET, SACRAMENTO, CALIFORNIA 95814

Commission Report 84-4

Adopted January 30, 1984

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INTRODUCTION

LOANS are one of three main forms of student financial aid, the other two being: (1) grants, such as scholarships and fellowships, which are either direct payments or exemptions from obligation for all or some educational costs, with no repayment required, and (2) work-study, which is part-time employment with the salary at least partially subsidized by someone other than the employer. Loans can be either temporary payments to defray educational costs, or temporary exemptions from obligation for these costs, with repayment required. All three forms of aid are awarded largely on the basis of financial need, although scholarship and fellowship awards may include consideration of academic achievement.

Historically, students who needed to borrow money to attend college have sought loans from relatives, family friends, their college or university, or, if necessary, commercial lending institutions. Today, the largest source of loan funds is commercial lenders, under the federal Guaranteed Student Loan program (GSL). This program uses federal funds (1) to subsidize below-market interest rates on loans that commercial lenders make to students, (2) to pay interest on those loans to lenders while borrowers are still in school, and (3) to guarantee the loans against default.

While the Guaranteed Student Loan program is today's largest source of student loan funds, it is not the only federally supported loan program: The National Direct Student Loan program (NDSL) provides funds to colleges and universities for making their own low-interest loans to their students. It is funded through a combination of federal contributions, institutional funds, and loan collection revenues from former borrowers.

This report describes California's participation in guaranteed student loan programs by examining four facets of the topic:

- Part One traces the history of federal involvement in student loan programs.
- Part Two then explains California's past and current involvement in the federal programs.
- Part Three presents a profile of California student borrowers drawn from an analysis of the California Student Expenses and Resources Survey (SEARS) conducted by the California Student Aid Commission.
- And Part Four discusses two issues that follow from these data: increasingly high levels of student debt and default rates under the Guaranteed Student Loan program.

Because the Guaranteed Student Loan program has spawned a unique set of terminology over its 17-year history, a list of some of the major terms associated with it is included as a glossary on pages 27-29.

ONE

History of Federal Involvement in Student Loans

FEDERAL support for postsecondary education can be traced to 1802 when the United States Military Academy was established. Later, the Naval Academy and Howard University were funded by the federal government, and the states received grants of federal land under the 1862 Morrill Act to support their agricultural and mechanical colleges. Although these grants were small, they established a precedent for federal support of state higher education institutions. With the passage of the Serviceman's Readjustment Act or "G.I. Bill" in 1944, the federal government began to pour large sums of money into the support of higher education generally. The unexpected success of this act in encouraging veterans to continue their schooling paved the way for the many federal student aid programs that have followed.

THE NATIONAL DEFENSE STUDENT LOAN PROGRAM OF 1958

The National Defense Education Act of 1958, the federal government's educational response to the Russian challenge of Sputnik, not only provided research fellowships and grants to institutions to improve instruction primarily in engineering, science, and teaching; it also established the National Defense Student Loan program (renamed the National *Direct* Student Loan program in 1972) to supply capital to postsecondary institutions for low-interest loans to full-time students. Federal appropriations provide up to 90 percent of the capital for these loans, with institutional funds supplying the remaining 10 percent. Loan repayments go into a revolving fund at the institution in order to make new loans to students.

This campus-based program is administered by the institutions independently, with each institution selecting its borrowers from a need-eligible pool and assuming responsibility for servicing loans and collecting repayments. Originally if loan funds were limited, federal regulations instructed institutions to give special consideration to students with a strong academic background who wanted to teach in elementary or secondary schools and to those interested in science, mathematics, engineering, or modern foreign languages. When the program began, students could borrow up to $1,000 a year for a cumulative total of $5,000 at an annual interest rate of 3 percent. Repayment began one year after the borrower ceased to be a full-time student and extended over a ten-year period, with interest accruing only from the beginning of the repayment period. Repayment could be deferred up to three years if the borrower served in the military or Peace Corps. Partial forgiveness of the loan was permitted to those borrowers who became full-time teachers in a public elementary or secondary school, in which case, half the loan could be canceled at a rate of 10 percent a year for up to five years of teaching.

Currently, the National Direct Student Loan program allows undergraduates to borrow up to a total of $6,000 toward their bachelor's degree and graduate and professional students up to $12,000, including any undergraduate loans received under the program. The current interest rate is 5 percent, and repayment begins six months after the borrower ceases to carry at least a half-time academic load, but can be deferred up to three years for service in the military, Peace Corps, as a Officer with the U.S. Public Health Service, and under several other circumstances. The repayment period remains ten years but may be extended for low-income borrowers.

The program began with an appropriation of $31 million in 1958-59 and reached its peak appropriation of $321 million in 1975 and 1976. As Table 1 on page 4 shows, federal appropriations have declined steadily since then to $186 million in 1981, by which time over 11.5 million students had borrowed over $7.5 billion under it. Currently, the Administration proposes to consolidate all federal student financial aid programs into one grant, one loan, and one work-study program. If this plan is adopted, the National Direct Student Loan program would no longer receive new capital contributions.

TABLE 1 Magnitude of the National Direct Student Loan Program, 1959 - 1981

Fiscal Year	Federal Capital Contribution Appropriation (in 000's)[a]	Federal Capital Contribution Allocation (In 000's)[a]	Loans To Students (In 000's)[b]	Number of Borrowers	Average Loan	Number of Participating Institutions
1959	$ 30,883	$ 30,805	$ 9,502	24,831	$ 383	1,196
1960	40,393	40,383	50,152	115,450	434	1,359
1961	57,474	57,454	70,962	151,068	470	1,412
1962	73,845	73,837	89,102	186,465	478	1,470
1963	90,000	90,048	113,732	216,930	478	1,528
1964	121,168	108,469	119,536	246,840	484	1,560
1965	145,000	130,014	166,608	319,974	522	1,616
1966	179,300	179,285	214,333	377,722	568	1,639
1967	190,000	176,238	221,600	395,000	561	1,694
1968	190,000	178,376	233,700	429,000	521	1,738
1969	190,000	182,904	240,839	455,998	540	1,818
1970	188,785	188,587	240,541	452,144	532	1,867
1971	236,500	226,879	311,965	547,307	570	2,092
1972	309,600	309,600	397,749	645,696	616	2,186
1973	286,000	286,000	433,000	655,000	661	2,293
1974	286,000	285,850	440,000	680,000	647	2,643
1975	321,000	321,000	460,000	690,000	667	2,985
1976	321,000	320,766	559,487	764,591	732	3,167
1977	310,500	321,000	614,868	795,134	773	3,284
1978	310,500	307,732	640,424	808,616	792	3,326
1979	310,500	308,708	645,684	933,190	677	3,274
1980 (est.)	286,000	284,781	710,816	860,552	826	3,222
1981 (proj.)	186,000	186,000	647,598	780,238	830	3,500
	$4,660,448	$5,402,716	$7,632,198	11,551,746		

a. Added to the Revolving Loan Fund. Does not include funds appropriated for loans for institutions and reimbursement for cancellation of student loans.

b. Funds for loans to students is primarily comprised of the Federal Capital Contribution (FCC), institutional shares, collections from borrowers, and federal reimbursement for cancellation of student loans.

Source: OSFA Program Book, July 1981. U.S. Department of Education, Office of Student Financial Assistance.

THE GUARANTEED STUDENT LOAN PROGRAM OF 1965

Just as the National Defense Education Act was a response to Sputnik, the Higher Education Act of 1965 was a response to the civil rights movement of the early '60s. Part of President Johnson's "War on Poverty," its goal was to provide an opportunity for postsecondary education to all qualified students, particularly those with financial need. This Act created the original Guaranteed Student Loan program, providing federal insurance against defaulted loan losses of private lenders. A loan program with federal guarantees was deemed necessary to encourage lenders to loan money to students because students usually have no credit history, little income, and usually would not be considered credit worthy for loan purposes. In the initial Guaranteed Student Loan program, loans were made at 6 percent. Undergraduate students from families with adjusted gross annual incomes of under $15,000 could borrow up to $2,500 per year for a total cumulative amount of $10,000 and graduate and professional students could borrow up to $5,000 a year for an undergraduate and graduate total of $15,000. Repayment was not required to begin until the borrower had been out of school for nine months and could be deferred up to three years under special circumstances.

The Guaranteed Student Loan program technically has two parts -- the guarantee agency program, and the Federal Insured Student Loan program -- but the second is now virtually inoperative. Under the guarantee agency program, state agencies such as the California Student Aid Commission or private nonprofit agencies, guarantee student loans that are in turn insured by the federal government against default. The guarantee agencies administer the program and help locate lenders to finance the loans. Under the Federal Insured Student Loan program, lenders in states that do not have guarantee agencies or in which lenders do not have access to the guarantee agency program can be insured directly against losses on their loans. Currently, all 50 states have guarantee agencies.

The first major change in the Guaranteed Student Loan program came in its third year (1968), when the federal government raised the interest rate one percentage point to 7 percent. A year later, it agreed to pay lenders a "Special Allowance" to compensate for the disparity between the increasing market rate for borrowing and the fixed interest rates they were receiving. This Special Allowance was based on the dollar value of the unpaid principal of all eligible student loans. It was set quarterly by a government committee and could not exceed 3 percent of the lender's outstanding student loan balance.

The next major change in the Guaranteed Student Loan program occurred with passage of the 1976 Higher Education Act Amendments. In an effort to improve the administration of the program by increasing state participation as guarantee agencies, these amendments provided for 100 percent federal reinsurance of loans for those states with low default rates. Previously, the federal government covered only 80 percent of loan defaults, and the states were responsible for the remaining 20 percent. The amendments granted all states higher administrative cost allowances to aid in collecting on defaults; they sought to increase lender participation by tying the special allowance to changes in the Treasury Bill rate; and recognizing that average family income was rising, they raised the family income ceiling to $25,000. Two years later, the Middle Income Student Assistance Act of 1978 removed the income ceiling entirely. This meant that all students, regardless of family income, could receive a 7 percent interest loan and qualify for the interest subsidy while they were in school. This Act marked a major explicit shift in federal financial aid objectives by expanding eligibility for federal aid to middle-income families. Since 1981, however, the law has required that students meet a needs test if their family income is over $30,000.

Several further changes in the program were made by education amendments in 1980 and 1981:

- First, although annual borrowing limits remained the same, the cumulative amount that undergraduates could borrow was raised from $10,000 to $12,500 while the graduate/professional limit was increased from $15,000 to $25,000.
- Second, the interest rates for borrowers after January 1, 1981, increased from 7 to 9 percent, and the nine-month grace period before repayment begins was shortened to six months.
- Third, students were charged a 5 percent "loan origination" fee deducted from the face value of loans made after August 1981. This fee is retained by the lenders and helps reduce federal expenditures because it is an offset to federal interest and special allowance payments. To summarize the program as it is today, undergraduate students may borrow up to $2,500 per year up to a cumulative total of $12,500, while graduate/professional students may borrow up to $5,000 per year or an aggregate total of $25,000. All students pay a 5 percent loan origination fee, which is deducted from the face value of the loan, and the interest rate for new borrowers is now 8 percent. Since its inception 18 years ago, the Guaranteed Student Loan program has provided 21 million loans and over $35 billion to borrowers (see Table 2 on page 6). The average loan has been $2,213.

PARENT LOANS FOR UNDERGRADUATE STUDENTS AND AUXILIARY LOANS TO ASSIST STUDENTS

In addition to making changes in the Guaranteed Student Loan program, the Education Amendments of 1980 authorized a parent loan component of this program. Parent Loans for Undergraduate Students (PLUS) is a guaranteed student loan program that allows parents of dependent undergraduate students to borrow money for school expenses and is designed for parents with cash-flow problems. These loans are similar to Guaranteed Student Loans in that they are financed by private lenders, guaranteed

TABLE 2 Annual and Cumulative Commitment of the Guaranteed Student Loan Programs, 1966 - 1980

Fiscal Year	Annual Loan Volume Number (000s)	Annual Loan Volume $ Amount (Millions)	Average Loan $ Amount	Cumulative Loan Volume Number (000s)	Cumulative Loan Volume $ Amount (Millions)
Guarantee Agency Program					
1966-1969	1,291	1,135	879	1,291	1,135
1970	498	457	918	1,789	1,592
1971	535	531	993	2,324	2,123
1972	509	566	1,112	2,833	2,689
1973	431	516	1,197	3,264	3,205
1974	431	528	1,225	3,695	3,733
1975	486	637	1,311	4,181	4,370
1976*	776	1,088	1,402	4,957	5,458
1977	651	1,037	1,593	5,608	6,495
1978	817	1,485	1,818	6,425	7,980
1979	1,233	2,443	1,981	7,658	10,423
1980	2,078	4,336	2,086	9,736	14,759
1981	3,340	7,367	2,206	13,076	22,126
1982**	2,672	5,099	2,208	15,748	28,025
Federal Insured Student Loan Program					
1966-1969	331	284	858	331	284
1970	365	354	970	696	638
1971	482	484	1,004	1,178	1,122
1972	692	708	1,023	1,870	1,830
1973	599	655	1,094	2,469	2,485
1974	507	612	1,207	2,976	3,097
1975	505	661	1,309	3,481	3,758
1976*	522	740	1,418	4,003	4,498
1977	322	500	1,553	4,325	4,998
1978	268	473	1,765	4,593	5,471
1979	277	541	1,953	4,870	6,012
1980	236	504	2,136	5,106	6,516
1981	189	427	2,260	5,295	6,943
1982*	100	234	2,330	5,395	7,177
Total Guaranteed Student Loan Program					
1966-1969	1,622	1,419	875	1,622	1,419
1970	863	811	940	2,485	2,230
1971	1,017	1,015	998	3,502	3,245
1972	1,201	1,274	1,061	4,703	4,519
1973	1,030	1,171	1,137	5,733	5,690
1974	938	1,140	1,215	6,671	6,830
1975	991	1,298	1,310	7,662	8,128
1976*	1,298	1,828	1,408	8,960	9,956
1977	973	1,537	1,580	9,933	11,493
1978	1,085	1,958	1,805	11,018	13,451
1979	1,510	2,984	1,976	12,528	16,435
1980	2,314	4,840	2,091	14,842	21,275
1981	3,529	7,794	2,209	18,371	29,069
1982**	2,772	6,133	2,213	21,143	35,202

* Figure for fiscal year 1976 includes transition quarter.

** Preliminary figures only.

Source: Office of Student Financial Assistance, U.S. Department of Education.

by state agencies, and reinsured by the federal government. Unlike the student loans, however, there is no in-school interest subsidy and repayment of the loan begins within 60 days of the loan disbursement. In addition, parents may borrow up to $3,000 per year for a cumulative total of $15,000 rather than the $2,500/$10,000 limit on undergraduates. The minimum annual repayment is $600 unless a lesser amount is agreed to initially by borrower and lender, and the repayment period can range between five and ten years.

Originally, the interest rate on PLUS loans was 9 percent, but in 1981, the Postsecondary Student Financial Assistance Amendments increased their interest rate to 14 percent -- 5 percent above the Guaranteed Student Loan level -- and expanded eligibility to graduate and professional students and to undergraduates who are financially independent of their parents. This expanded program is titled Auxiliary Loans to Assist Students (ALAS) but is usually referred to as PLUS. Unlike the loans to parents, the students borrowing under this program are allowed to defer repayment of the principal until they are no longer students. Under this program, graduate and professional students may borrow up to $3,000 per year up to a cumulative total of $15,000, in addition to any Guaranteed Student loans they may have, while undergraduate students may borrow only $2,500 per year (including any Guaranteed Student Loans) with an aggregate limit of $12,500. Currently, the interest rate for PLUS loans is 12 percent; in part, the interest rate is tied to the Treasury Bill rate.

To date, more than 92,000 people have borrowed over $238 million through the PLUS program. The average loan over the past three years has been $2,603. For the first six months of 1983, PLUS loan volume was approximately 4.1 percent of the Guaranteed Student Loan program volume.

THE ROLE OF GUARANTEED STUDENT LOANS IN THE FEDERAL GOVERNMENT'S TOTAL STUDENT FINANCIAL AID PROGRAM

Table 3 on page 8 shows the growth of the federal government's commitment to student financial aid since 1958-59 in terms of the three major categories of student aid -- (1) grants, (2) work study, and (3) loans. As can be seen, the federal government currently appropriates over $6.3 billion annually for all three types of programs.

Because of the phenomenal growth of the Guaranteed Student Loan program, the cost of the program to the government has increased greatly since it began. There are four major costs to the federal government associated with this program: (1) the interest subsidy paid to the lender while the borrower is still a student or in a deferment period; (2) the Special Allowance paid to the lender each quarter over the life of the loan; (3) the guarantee of principal and interest in case of default, bankruptcy, disability, or death of the borrower; and (4) operating expenses including the Administrative Cost Allowance paid to State agencies.

The in-school interest subsidy costs took a big jump with the increase in loan volume which resulted from the passage of the Middle Income Student Assistance Act. These costs should begin to decrease as more loans come into repayment and the number of applicants for loans stabilizes or decreases.

In recent years, the Special Allowance payment to lenders -- which is tied to the 91-day Treasury Bill rate -- accounted for almost half the growth in expenditures of the program due to the unprecedented high interest levels. In 1978 when the Treasury Bill rate averaged 7 percent, Special Allowance payments were $195 million. Just three years later, the allowance payments had grown to approximately $1.5 billion. These payments should decrease while interest rates are lower.

The guarantee payments due to defaults, bankruptcy, disability, or death also increased greatly, especially in the mid-1970s. This was due both to the increase in loan volume and the fact that a large number of loans made in the late 1960s and early 1970s came into the repayment stage. The percentage of defaults grew in part because little effort was made in the Federal Insured Loan program to collect on loans. At one point, the default rate reached 12 percent. Today, it is 9.3 percent. This problem is discussed further in Part Four.

As a result of the enormous increase in costs to the federal government, the current administration and others have proposed changes in the Guaranteed Student Loan program since the Government cannot put a cap on the amount of loans it will guarantee because the program is established in statute as an an entitlement program. Alternatives under consideration are as

TABLE 3 Federal Student Aid Appropriations for Major Programs, in Millions of Dollars, 1958-59 - 1983-84

	Grant Programs			Work Study	Loan Programs		
Year	Basic Educational Opportunity Grant	State Student Incentive Grant[1]	Supplemental Educational Opportunity Grant[2]	College Work Study	National Direct Student Loan[3]	Federal Insured Guaranteed Student Loan[4]	Total
1958/59	-	-	-	-	$ 31	-	$ 31
1959/60	-	-	-	-	41	-	41
1960/61	-	-	-	-	58	-	58
1961/62	-	-	-	-	75	-	75
1962/63	-	-	-	-	91	-	91
1963/64	-	-	-	-	122	-	122
1964/65	-	-	-	$ 56	147	-	203
1965/66	-	-	$ 58	99	182	$ 9	348
1966/67	-	-	112	134	192	43	481
1967/68	-	-	140	140	193	40	513
1968/69	-	-	125	140	193	75	533
1969/70	-	-	165	152	195	73	583
1970/71	-	-	168	158	243	161	730
1971/72	-	-	220	237	317	209	983
1972/73	$ 122	-	210	270	293	291	1,186
1973/74	475	$ 74	210	270	298	399	1,726
1974/75	840	20	240	420	329	594	2,443
1975/76	1,326	44	240	390	332	807	3,139
1976/77	1,904	60	250	390	323	357	3,284
1977/78	2,160	64	270	435	326	519	3,774
1978/79	2,627	77	340	550	311	970	4,375
1979/80	2,381	77	340	550	220	1,100	4,083
1980/81	2,420	77	370	550	186	1,609	5,212
1981/82	2,310	76	370	550	186	2,535	6,027
1982/83[5]	2,419	60	355	590	179	3,100	6,703
1983/84[5]	2,800	76	370	550	161	2,300	6,277

1. Aid to supplement State aid programs.
2. Prior to 1972, the program was called "Educational Opportunity Grants."
3. Prior to 1972, the program was called "National Defense Education Act."
4. Includes interest subsidies, special allowances, and default payments only.
5. Appropriations for 1982-83 and 1983-84 are estimated and will be replaced with actual data as it becomes available.

Sources: Congressional Budget Office and the U.S. Bureau of Student Financial Assistance.

follows: (1) have students pay interest on the loans while they are in school: (2) make GSL loans only to undergraduate students and have graduate students borrow through the PLUS program: (3) cut the Special Allowance from 3.5 percent above the Treasury Bill rate to the Treasury Bill rate plus 2 percent: (4) require a needs test of all applicants: and/or (5) increase the loan origination fee to 10 percent.

Which, if any, of these proposals will be implemented is uncertain. The current administration's philosophy on student financial assistance is shifting to student "self-help" grants and to a more traditional emphasis on parental and student contributions to the costs of a college education and away from the more recent emphasis on grants and subsidized loans. Another factor contributing to the uncertainty is the pending 1985 reauthorization of the Higher Education Act of 1965.

SECONDARY MARKETS AND THE STUDENT LOAN MARKETING ASSOCIATION

A major concern for large-volume lenders in the Guaranteed Student Loan program was the lack of liquidity due to the fact that student loans had a long repayment period. In order to provide liquidity and to encourage more private lender participation in the Guaranteed Student Loan program, the 1972 Congress created the Student Loan Marketing Association (Sallie Mae), a private corporation designed to provide a national secondary market for student loans. As a secondary marketer, Sallie Mae buys student loan portfolios from primary lenders such as savings and loan associations, banks, and credit unions, creating liquidity for these lenders and, thus, making more funds available from them for new student loans. After purchasing the loan portfolios, Sallie Mae is responsible for servicing the loans and collecting repayment.

In addition to purchasing student loans, Sallie Mae can "warehouse" them. In this case, the lender borrows money from Sallie Mae using student loans as collateral and retains the responsibility for servicing the loans and repayment.

The 1980 Education Amendments extended the responsibilities of Sallie Mae to cover any activities designed to support the credit needs of students. Under them, Sallie Mae could, for example, consolidate loans for students with more than one federal loan and could act as a lender of last resort to students in states where federal loan availability was insufficient. Whether Sallie Mae will continue to be able to consolidate loans is not known at this point. The Act was not extended beyond November 1, 1983, because of disagreements between the Administration and Congress over the costs of the program and between the different houses over the role of state guarantee agencies. Some members of Congress want all state guarantee agencies to be able to consolidate loans.

Helped by the fact that it was able to borrow funds from the Federal Financing Bank at a rate one-eighth of a percentage point over the government borrowing rate, Sallie Mae has been extremely successful financially, with its net income tripling from $6.3 to $18.0 million between 1979 and 1981 alone. As of 1982, however, it no longer had favored borrowing status from the Federal Financing Bank and must borrow on the private market. Coupled with the fact that a number of states and lending institutions have established secondary market operations, this competition will no doubt affect Sallie Mae and the nature of the secondary market itself. In its first decade of operation, Sallie Mae has provided more than $10 billion for student loan programs.

The establishment of a secondary market for student loans was (and is) essential for a successful student loan program. Student loans tie up capital for an extended period of time because of the long repayment period. Lenders want to be able to sell their loan portfolios if the need arises, and many do not want the expense of servicing loans once they go into repayment.

Currently, Sallie Mae will buy student loans if the lender's average student loan indebtedness is $4,100 or more. This is one reason why some lenders have restrictions on the minimum amount they will loan. Previously, Sallie Mae's restrictions on average loan indebtedness was slightly higher, and thus improvements have been made as far as lenders are concerned.

TWO

California's Participation in Student Loan Programs

THE STATE'S INITIAL VENTURE IN GUARANTEEING STUDENT LOANS

California began participating in the federal Guaranteed Student Loan program in 1966, when the passage of Assembly Bill 56 established the State Guaranteed Loan program in order to allow California to take advantage of the one-year-old program. The State Scholarship Commission was renamed the State Scholarship and Loan Commission to administer the new program, and it established a Guaranteed Loan Advisory Committee, composed of representatives of the University of California, the California State University, the California Community Colleges, independent colleges and universities, banks, savings and loan associations, and credit unions, to review procedures and recommend policy to the Commission.

Because the Committee anticipated a high demand for loans, it recommended that the Commission limit both undergraduate and graduate student borrowers to a maximum loan of $1,000 per year. In order to encourage lender participation in the program, the Commission guaranteed 100 percent of the principal amount of the loans, rather than the minimum 80 percent required by federal legislation.

The Scholarship and Loan Commission guaranteed the first loans under the California State Guaranteed Loan program in October 1966, and a year later increased the maximum amount of the loans for graduate students to $1,500. During the second year of the program, however, it received some 2,000 more applications for loans than could be handled, since by November 1967 all federal funds for guaranteeing the loans were encumbered. With these funds fully committed, the State Guaranteed Loan program ceased operation, and in December the Federal Insured Student Loan program -- the federal standby program -- began operation in California under the administration of the U.S. Office of Education regional office in San Francisco.

During 1968, the Scholarship and Loan Commission studied the feasibility of resuming administration of the Guaranteed Student Loan program. However, it decided not to do so, since administering the program would cost approximately $3,150,000 over the first three years, while the federal government would administer the Federal Insured Student Loan program at no charge to the State. Thus, for a decade, the Commission's role regarding guaranteed loans was limited to purchasing defaulted loans from lenders and making additional efforts to collect on these loans.

THE STATE'S SECOND EFFORT AT PARTICIPATION

As mentioned previously in Part One, the Higher Education Act Amendments of 1976 encouraged states to assume responsibility for administering the federal loan programs by offering them new incentives and funds, because experience had shown that the default rate was lower and the funding level higher in those states with guarantee agencies. Thus, California resumed participation in the Guaranteed Student Loan program in 1977, when Assembly Bill 647 established the California Guaranteed Student Loan program and designated the Student Aid Commission (the renamed Scholarship and Loan Commission) as its administrator. In October 1978, the Commission signed an agreement with the U.S. Office of Education and as a guarantee agency became entitled to federal reinsurance, administrative cost allowances, interest benefits, and federal advance monies on the loan reserve fund. With the advent of this program, the role of the Federal Insured Student Loan program in California was reduced to making only renewal loans.

The program accepted its first student applicant on April 1, 1979, and in its first year of operation guaranteed 76,127 loans in the amount of nearly $174 million. This amount almost tripled in its second year of operation. As Table 4 on page 12 shows, over $2 billion has been loaned to students. The largest amount of loans -- $603 million or almost 30 percent -- have gone to students at private four-year schools, with loans to California State University students the second largest at $404 million or 19.9 percent (Table 5).

TABLE 4 Number and Dollar Value of Loans, California Guaranteed Student Loan Program, 1979-80 Through 1983-84

Year	Number of Loans	Amount of Loans
1979-1980[1]	76,127	$ 173,932,306
1980-1981	182,962	469,593,688
1981-1982	237,825	654,352,000
1982-1983	200,323	550,705,000
July and August, 1983	52,491	155,736,000
Total	749,728	$2,004,318,994

1. April through June, 1980 only.

Source: California Student Aid Commission data.

TABLE 5 Comparison of Loans Guaranteed by Educational Segment, California Guaranteed Student Loan Program, 1981-82 and 1982-83

	Dollars of Loans				Percent of Total		
Segment	1981-82	1982-83	Percent Change 1981-82 to 1982-83	Cumulative Through July 31, 1983	1981-82	1982-83	Cumulative Through July 31, 1983
University of California	$104,156,035	$70,311,000	-32.5%	$307,174,025	15.9%	12.8%	15.1%
California State University	130,799,663	95,583,000	-26.9	404,001,805	20.0	17.3	19.9
Community Colleges	90,380,614	72,074,000	-20.3	224,876,829	13.8	13.1	11.1
Private Four-Year	179,847,387	149,859,000	-16.7	602,738,776	27.5	27.2	29.7
Vocational	85,684,894	101,996,000	19.0	272,810,410	13.1	18.5	13.4
Private Two-Year	11,089,195	10,961,000	-1.2	37,443,093	1.7	2.0	1.8
Hospital	1,005,273	909,000	-9.6	3,509,080	0.2	0.2	0.2
Out-of-State	49,224,776	47,720,000	-3.1	173,379,985	7.5	8.7	8.5
Out-of-Country	2,164,163	1,292,000	-40.3	6,414,324	0.3	0.2	0.3
Total	$654,352,000	$550,705,000	-15.8%	$2,032,338,327	100.0%	100.0%	100.0%

Source: California Student Aid Commission

As can be seen in Table 5, loan volume dipped for all segments except the vocational in 1982-83. This was due to the confusion among students that resulted from the 1981 requirement that students meet a needs test if their family income was over $30,000, and additionally to the fact that demand was down because in the previous two years the California Guaranteed Student Loan program was able to meet the demands of all of the segments except the vocational. This past year, the demand for loans in the vocational segment were met due to a loosening of lenders' restrictions on loans. As of the end of October, loan volume for this fiscal year (July-October) was over $305 million, an increase of 15 percent over the same period last year, but a 22 percent decrease from the 1981-82 year. The Student Aid Commission anticipates that loan volume will be up in all segments in 1983-84 and estimates the total to be in the range of $625 to $650 million.

CALIFORNIA SECONDARY MARKETS AND THE CALIFORNIA LOAN AUTHORITY

In 1980, the Legislature created the California Loan Authority to supply an additional secondary market for Guaranteed Student Loan lenders. This additional market was needed because California was suffering shortages of student loan capital due both to the success of the Guaranteed Student Loan program and to Sallie Mae's placing additional requirements on its purchase agreements and requiring that the lenders' student-loan portfolio average $4,000. In addition, some needy students were not being served by the existing programs because they could not meet the requirements of the lenders.

In order to increase lender liquidity and to serve students better, the Legislature empowered the Authority to issue tax exempt revenue bonds in an initial amount of $150 million in order to provide financing for new loans (forward commitment) and to provide financing for the purchase of insured student loan portfolios (secondary market). The Authority's initial offering in January 1983, netted $121,475,000. To date, the Authority has only a forward commitment program, and its bond issue proceeds are being used primarily for the California Loans to Assist Students (CLAS) program. As of October 31, 1983, only $13.9 million had been loaned through this program.

This past year, the Legislature authorized the Authority to issue additional tax exempt revenue bonds up to $150 million. Although the funds are not required at the moment, it gives the Authority the ability to raise more funds if they are needed for the Guaranteed Student Loan program or should it decide to operate as a secondary market.

Although the California Loan Authority is not currently operating as a secondary market, there is another secondary market for student loans in California. The California Student Loan Finance Corporation is a non-profit corporation which raises capital through the sale of tax exempt revenue bonds. To date, they are financed to about $300 million and have purchased $100 to $150 million of guaranteed student loans. As of the end of August 1983, Sallie Mae and the California Student Loan Finance Corporation held 23 percent of the outstanding guaranteed loans and 44 percent of the matured paper in California.

It appears that currently California has sufficient secondary markets for purchasing guaranteed student loans. If more funds are needed, the California Loan Authority can become a secondary market, and Sallie Mae and the California Student Loan Finance Corporation can increase their purchasing of loans.

CALIFORNIA LOANS TO ASSIST STUDENTS (CLAS)

In 1982, California began participating in the two-year old federal program of Parent Loans for Undergraduate Students (PLUS) and the one-year-old program of Auxiliary Loans to Assist Students (ALAS) and called its program "CLAS"--California Loans to Assist Students. CLAS regulations are similar to the federal requirements: parents and graduate students may borrow up to $3,000 per year for an aggregate of $15,000 per student, and graduate students may use these funds to supplement up to $5,000 per year in guaranteed student loans. Independent undergraduate students may borrow up to $2,500 per year, but their total loan obligation under all the programs may not exceed $2,500 annually or an aggregate of $12,500. The minimum that can be loaned is $500. Parents and part-time students must start repayment of both loan principal and the 12 percent interest 60 days after their loan is made.

Full-time students must begin paying interest at the same time but may defer payments on the principal until they are no longer students. Unless the lender and borrower have a special agreement, the minimum annual repayment is $600 over a period of five to ten years.

When the CLAS program began, lenders were reluctant to get into the program because loans go into repayment within 60 days, and they are more expensive to service than outstanding loans. However, this problem was eliminated by the forward commitment program of the California Loan Authority. By providing for the purchase of CLAS loans simultaneously with their origination, it induced lenders to originate new loans for the CLAS program.

Some parents have been unable to borrow under the CLAS program due to the California Student Aid Commission's policy requiring lenders to perform a credit analysis on parent borrowers for CLAS loans. The analysis procedure is similar to that used for unsecured consumer loans, and employment verification is also required. As a result of this policy, 290 applicants or 45.3 percent of parents applying have been denied loans. The majority of these -- 31.6 percent -- were denied loans because of excessive debt obligations relative to income, and 9.1 percent for program reasons, such as applying for more money than they were entitled to or applying for ineligible schools.

CLAS lenders issued the first loans under the program in April 1983. As of the end of August, they had disbursed over $9 million, with students at independent institutions borrowing 80 percent of the total (Table 6). Ninety-four percent of the borrowers have been graduate students, compared to 4 percent independent undergraduates and 2 percent parents. In September and October, an additional $4.5 million was borrowed, bringing the cumulative total of CLAS loans to $13.9 million. The CLAS program has not had the demand that was originally expected. This may be due to the fact that (1) the interest rate is higher than that for Guaranteed Student Loans, (2) the repayment begins within 60 days of loan disbursement, and (3) many people are unaware of the program due to its newness. In July and August, CLAS loans were approximately 2.2 percent of GSL loans in California. Nationally, PLUS loan volume is about 4 percent of GSL volume.

Currently between the California Guaranteed Student Loan and California Loans to Assist Students programs, the California Student Aid Commission has guaranteed $2.0 billion in loans.

TABLE 6 Summary of Loans Guaranteed Through August 31, 1983, California Loans to Assist Students Program, by Educational Segment

Segment	Number of Loans	Percent of All Loans	Total Dollars of Loans	Percent of All Dollars	Average Amount
University of California	210	6.2%	$ 566,389	6.1%	$2,697
California State University	81	2.4	215,704	2.3	2,663
Community Colleges	8	0.2	18,236	0.2	2,280
Private Four-Year	2,691	79.9	7,471,225	80.6	2,776
Vocational	236	7.0	587,101	6.3	2,488
Private Two-Year	25	0.7	65,875	0.7	2,635
Hospital	0	0	0	0	0
Out-of-State	115	3.4	329,582	3.6	2,866
Out-of-Country	5	0.2	15,000	0.2	3,000
Total	3,371	100.0%	$9,269,112	100.0%	$2,750

Source: Student Aid Commission.

19

THREE

Guaranteed Student Loan Applicants and Recipients in California

WHAT policies do California lenders have for loaning funds under the Guaranteed Student Loan program? Who are the students that apply for these loans? What other financial resources do they have?

Information to answer these questions has been gathered by the California Student Aid Commission, which conducted the California Student Expenses and Resources Survey (SEARS) in Spring 1983 that covered the 1982-83 academic year. Results were obtained from over 23,000 students in five segments -- the University of California, the California State University, the California Community Colleges, independent colleges and universities, and proprietary schools. Of the 23,000 students who responded, some 6,000, or nearly 26 percent, had applied for loans in the Guaranteed Student Loan program, although approximately 12 percent of this group had not heard whether or not they had received a loan at the time they participated in the survey. The following pages describe California loan applicants, based on these SEARS data. (The number of respondents indicated in the tables on the following pages reflect the number of students who actually completed the SEARS survey instrument and have not been weighted to reflect total enrollment or the number of Guaranteed Student Loan applicants and recipients in the segments. The total numbers (N) in the tables vary because of differences in the number of unknown responses to individual questions.)

LENDER RESTRICTIONS ON LOANS

In 1979-80, the first year of the California Guaranteed Student Loan program, certain groups of California students had problems in obtaining guaranteed loans from commercial lenders due to these lenders' restrictive policies, many of which stemmed from wariness following their previous experience with the Federal Insured Student Loan program. Most affected were freshmen, Community College, and proprietary school students. The loosening of lenders' restrictions, coupled with a near doubling of the number of lenders and the policy of the Student Aid Commission not to deny access to certain types of institutions nor to restrict loans to certain kinds of students, has greatly increased these students' access to guaranteed student loans. Today, only 14 percent of the lenders will not give loans to Community College students, compared with 39 percent in 1979, and only 26 percent will not give loans to proprietary school students, compared with 56 percent then. Table 7 below indicates the present policies of California lenders.

TABLE 7 Selected Policies of 73 California Guaranteed Student Loan Program Lenders, 1983-84

Category of Student	Loan Without Conditions	Loan With Conditions	Loan to Repeat Borrowers Only
Community College Students	50	2[1]	2
Proprietary School Students	40	12[2]	2
Less-Than-Full-Time Students	40	3	1
Freshmen	57	5[3]	1
Lenders Requiring a Deposit/Customer/Member Relationship	49		

1. One lender will loan only if the student is in a full-year course; one only to students at the local Community College.
2. One lender will loan only to nursing students at the local Community College; one requires 30 completed units; one requires a 3.0 grade point average of new borrowers; six loan only to students at pre-approved schools; and three loan only on a case-by-case basis.
3. All five lenders require a 3.0 grade-point average.

Source: Excerpted from California Student Aid Commission, 1983.

As a result of these changes, unlike a few years ago, proprietary students today have an equal opportunity as other students of obtaining guaranteed loans. As Table 8 below shows, nearly 88 percent of those applying received loans, compared to nearly 87 percent of all applicants. Only students at independent colleges and universities had a higher acceptance rate (90 percent), while Community College students had the lowest acceptance rate (76 percent).

TABLE 8 Rates of Acceptance for Loans Under the Guaranteed Student Loan Program, by Segment, 1982-83

Segment	Sample Who Applied for Loans		Applicants Who Received Loans*	
	No.	%	No.	%
University of California (N = 5,552)	1,671	30.1%	1,314	87.4%
California State Univ. (N = 5,766)	1,071	18.6	782	82.6
Community Colleges (N = 5,411)	280	5.2	178	76.1
Independent Institutions (N = 4,438)	1,783	40.2	1,404	90.0
Proprietary Institutions (N = 2,143)	1,153	53.8	907	87.7
Total (N = 23,265)	5,959	25.6	4,585	86.9%

* These numbers and percentages represent only those who applied and had heard whether or not they received loans.

Source: California Student Expenses and Resources Survey, California Student Aid Commission Data

The California Student Aid Commission guarantees about 95 percent of all the applications it receives. The 8 percentage point difference between this rate and the 87 percent receipt rate results from a variety of factors, including student borrowers deciding not to return to school, or finding other sources of funds, as well as from lenders' policies.

CHARACTERISTICS OF STUDENT APPLICANTS

Institution Attended: Large differences exist among California's segments of postsecondary education in the percentage of their students who apply for loans (Table 8). In the Student Aid Commission survey sample, a high of 54 percent of the proprietary school students applied, followed by 40 percent of students at independent colleges and universities, 30 percent of students at the University of California, 19 percent of those at the California State University, and 5 percent at the Community Colleges. These differences can be explained in part by the substantial differences in the average cost of attendance in the five segments.

Student Load and Level: Close to one-third of all full-time undergraduates applied for guaranteed loans, compared to less than 10 percent of half-time undergraduates (Table 9). A higher percentage of graduate students -- nearly 26 percent -- applied for loans than any other level of student, followed by 25 percent of the seniors and 23 percent of the freshmen (Table 10, page 17). As noted earlier, in the past freshmen had problems obtaining loans, but this is no longer the case with nearly the same percentage of those applying receiving loans as among all applicants.

TABLE 9 Student Load of Guaranteed Student Loan Applicants, 1982-83

Student Load	Sample Who Applied for Loans		Applicants Who Received Loans	
	No.	%	No.	%
Full-Time Undergrad. (N = 13,307)	4,158	31.3%	3,135	86.0%
Half-Time Undergrad. (N = 2,724)	261	9.6	175	79.6
Part-Time Undergrad. (N = 1,631)	28	1.7	15	57.7
Graduate (N = 4,823)	1,248	25.8	1,038	91.7
Noncredit (N = 677)	225	33.2	178	88.1
Total (N = 23,162)	5,915	25.5%	4,542	86.0%

Source: California Student Expenses and Resources Survey, California Student Aid Commission Data

Sex: The percentage of men and women in the sample who applied for guaranteed loans was essentially the same, although women were slightly more successful in obtaining loans -- 88 percent, compared to 86 percent (Table 11).

TABLE 10 Student Level of Guaranteed Student Loan Applicants, 1982-83

Student Level	Sample Who Applied for Loans		Applicants Who Received Loans	
	No.	%	No	%
Freshmen (N = 5,701)	1,298	22.8%	1,127	86.8%
Sophomore (N = 3,927)	778	19.8	638	82.0
Junior (N = 4,155)	932	22.4	788	84.5
Senior (N = 3,549)	892	25.1	777	87.1
Fifth Year (N = 1,730)	262	15.1	230	87.8
Graduate (N = 4,281)	1,104	25.8	1,017	92.1
Total (N = 23,343)	5,266	22.6%	4,577	86.9%

Source: California Student Expenses and Resources Survey, California Student Aid Commission Data

TABLE 11 Sex of Guaranteed Student Loan Applicants, 1982-83

Sex	Sample Who Applied for Loans		Applicants Who Received Loans	
	No.	%	No.	%
Women (N = 13,332)	3,401	25.5%	2,649	87.9%
Men (N = 9,978)	2,558	25.6	1,924	85.6
Total (N = 23,310)	5,959	25.6	4,573	87.0%

Source: California Student Expenses and Resources Survey, California Student Aid Commission Data

Age: As can be seen from Table 12, nearly 27 percent of the applicants were under 20, while nearly 60 percent were from 20 to 29 years old and only 9 percent were over 40. The age of applicants differs considerably by segment, with 21 percent of the 40-year-old or older Community College students applying, compared with 7 percent at the State University, 6 percent at independent and proprietary institutions, and 2 percent at the University -- reflecting the extent of nontraditional enrollments at the Community Colleges.

TABLE 12 Age of Guaranteed Student Loan Applicants, 1982-83

Age Group	Sample Who Applied for Loans		Applicants Who Received Loans	
	No	%	No	%
Under 20 (N = 4,485)	1,194	26.6%	873	84.1%
20 to 24 (N = 9,228)	2,737	29.7	2,077	86.0
25 to 29 (N = 4,120)	1,174	28.5	947	90.8
30 to 39 (N = 3,524)	682	19.4	550	89.3
40 Plus (N = 2[illegible])	184	8.9	135	83.3
Total (N = 23,406)	5,972	25.5%	4,582	86.9%

Source: California Student Expenses and Resources Survey, California Student Aid Commission Data

Ethnicity: Wide variation exists in the percentage of students of different ethnic backgrounds applying for loans. Over half of Black students applied, compared with approximately one-third of Chicano-Hispanic students, and about one-fourth of white and Asian or Pacific Island students (Table 13). All groups had virtually similar acceptance rates, however, with only a 2 percentage point difference between high (white students) and low (Black).

TABLE 13 Ethnicity of Guaranteed Student Loan Applicants, 1982-83

Ethnic Group	Sample Who Applied for Loans		Applicants Who Received Loans	
	No.	%	No	%
Asian or Pacific Islander (N = 1,898)	504	26.6%	392	86.3%
Black (N = 739)	392	53.0	295	85.3
Chicano-Hispanic (N = 1,285)	494	38.4	394	87.0
White (N = 16,271)	4,125	25.4	3,242	87.3
Other (N = 961)	315	32.8	246	84.5
Total (N = 21,154)	5,831	27.6%	4,569	86.9%

Source: California Student Expenses and Resources Survey, California Student Aid Commission Data

Parental Income: Table 14 shows the percentage of financially dependent students who applied for guaranteed loans by their parental income. Fifty-six percent of these students whose parents' incomes were under $12,000 applied for loans, compared to only 16 percent whose parents made over $60,000. As can be seen, a linear decrease in the percentage of dependent students who apply for loans occurs with increases in family income. Among independent or self-supporting students, 24 percent applied for loans.

Among dependent students, 44 percent of those applying came from families with parental incomes of $30,000 or over. With the recent federal income ceiling set at this amount for subsidized loans, these students had to demonstrate financial need in order to obtain their loans, but 81 percent did obtain them.

Parental Contributions: Half of the loan applicants -- both dependent and independent students -- reported receiving no financial assistance from their parents for educational expenses (Table 15), with these expenses defined as

TABLE 14 Parental Income of Guaranteed Student Loan Applicants, 1982-83

Income Level	Sample Who Applied for Loans		Applicants Who Received Loans	
	No	%	No	%
Under $12,000 (N = 1,510)	839	55.6%	674	89.6%
$12,000-$23,999 (N = 2,239)	961	42.9	774	91.1
$24,000-$35,999 (N = 2,827)	948	33.5	756	88.9
$36,000-$47,999 (N = 1,620)	530	32.0	401	82.5
$48,000-$59,999 (N = 1,267)	376	29.7	274	79.0
$60,000 or More (N = 2,014)	33	16.4	222	72.1
Independ. Students (N = 8,090)	1,962	24.3%	1,561	89.3%

Source: California Student Expenses and Resources Survey, California Student Aid Commission Data

TABLE 15 Parental Contribution to Education of Guaranteed Student Loan Applicants, 1982-83

Amount	Applicants Who Received Loans		Applicants Who Did Not Receive Loans		Total Applicants	
	No.	%	No.	%	No.	%
Nothing	2,343	44.7%	270	5.2%	2,613	49.9%
Under $225	302	5.8	42	0.8	344	6.6
$225 - $449	215	4.1	32	0.6	247	4.7
$450 - $899	304	5.8	28	0.5	332	6.3
$900 - $1,799	338	6.4	53	1.0	391	7.5
$1,800 - $2,699	242	4.6	50	1.0	292	5.6
$2,700 - $4,499	292	5.6	71	1.4	363	6.9
$4,500 - $6,749	197	3.8	55	1.0	252	4.8
$6,750 - $8,999	125	2.4	27	0.5	152	2.9
$9,000 Plus	203	3.9	52	1.0	255	4.9
Total	4,561	87.0%	680	13.0	5,241	100.0%

Source: California Student Expenses and Resources Survey, California Student Aid Commission Data

tuition and fees; books and supplies; room and board, if away from home during the academic year; transportation to and from the campus; and other expenses necessary for attendance. The other 50 percent of the applicants were divided equally between those receiving less than $1,800 from their parents and those receiving more. The percent receiving aid from their parents differed greatly by segment, ranging from a low of only 24 percent for Community College applicants, compared with 42 percent of those at proprietary schools, 47 percent at the California State University, 60 percent at independent colleges and universities, and 62 percent at the University of California.

Income: Eleven percent of the applicants or their spouses (if married) had no taxable income in the 1982-1983 academic year, while 56 percent earned under $6,000, and the remaining 34 percent earned over $6,000 (Table 16).

Student Contribution: As Table 17 on page 20 shows, 11 percent of the applicants made no financial contribution to their educational expenses, but 56 percent paid up to $2,700, and the remaining 26 percent paid more.

Other Aid: Over half of the applicants applied for other forms of financial aid beyond guaranteed loans (Table 18, page 20). Fifty-three percent applied for, and 27 percent received, federal Pell Grants; 44 percent applied for, and 19 percent received, Cal Grants: and 57 percent applied for, and 38 percent received some form of institutional financial aid. As shown in Table 19 on page 21, 63 percent of all applicants received scholarship or grant assistance. Sixteen percent received $999 or less, 27 percent $1,000 to $2,000, and 20 percent received more than $3,000.

Amount of Loan Aid: Although 13 percent of the students who applied for guaranteed loans were unsuccessful in obtaining their loan, only 8 percent reported receiving no educational loans from any source, as shown in Table 20 on page 21. Twenty-two percent received up to $2,000 in loans, 40 percent received from $2,000 to $3,000, and 30 percent received $3,000 or more.

TABLE 16 Total Income of Guaranteed Student Loan Applicants, 1982-83

	Applicants Who Received Loans		Applicants Who Did Not Receive Loans		Total Applicants	
	No.	%	No.	%	No.	%
Nothing	476	9.0%	79	1.5%	555	10.5%
Under $1,000	326	6.2	51	1.0	377	7.1
$1,000 - $1,999	709	13.4	102	1.9	811	15.4
$2,000 - $2,999	504	9.6	80	1.5	584	11.1
$3,000 - $5,999	1,020	19.3	153	2.9	1,173	22.2
$6,000 - $11,999	843	16.0	117	2.2	960	18.2
$12,000 - $17,999	284	5.4	38	0.7	322	6.1
$18,000 - $23,999	198	3.8	18	0.3	216	4.1
$24,000 - $31,999	121	2.3	18	0.3	139	2.6
$32,000 or More	104	2.0	34	0.6	138	2.6
Total	4,585	86.9%	690	13.1%	5,275	100.0%

Source: California Student Expenses and Resources Survey, California Student Aid Commission Data

TABLE 17 Contribution to Their Own Education of Guaranteed Student Loan Applicants, 1982-83

	Applicants Who Received Loans		Applicants Who Did Not Receive Loans		Total Applicants	
Amount	No.	%	No.	%	No.	%
Nothing	484	9.2%	70	1.3%	554	10.6%
Under $225	273	5.2	42	0.8	315	6.0
$225 - $449	356	6.8	73	1.4	429	8.2
$450 - $899	568	10.8	78	1.5	646	12.3
$900 - $1,799	761	14.5	116	2.2	877	16.7
$1,800 - $2,699	567	10.8	77	1.5	644	12.3
$2,700 - $4,499	627	12.0	95	1.8	722	13.8
$4,500 - $6,749	409	7.8	55	1.1	464	8.9
$6,750 - $8,999	171	3.3	26	0.5	197	3.8
$9,000 Plus	339	6.5	51	1.0	390	7.4
Total	4,555	87.0%	683	13.0%	5,238	100.0%

Source: California Student Expenses and Resources Survey, California Student Aid Commission Data

TABLE 18 Guaranteed Student Loan Applicants Who Applied for Other Forms of Financial Aid, 1982-83

	Applicants Who Applied for Pell Grants		Applicants Who Applied for Cal Grants		Applicants Who Applied for Institutional Aid	
Status	No.	%	No.	%	No.	%
Applied for Other Aid	2,779	52.9%	2,310	43.9%	2,967	56.5%
Received Other Aid	1,439	27.4	998	19.0	2,004	38.1
Had Not Heard	177	3.4	187	3.6	144	2.7

Source: California Student Expenses and Resources Survey, California Student Aid Commission Data

Loan Debt: Table 21 indicates that 38 percent of the guaranteed student loan applicants had no educational loan debts from prior years, but the remaining 62 percent were already indebted -- 14 percent at under $2,000, 31 percent from $2,000 to $6,000, 9 percent from $6,000 to $10,000, and another 9 percent from $10,000 or more.

TABLE 19 Current-Year Scholarship or Grant Assistance of Guaranteed Student Loan Applicants, 1982-83

Amount	Number	Percent
Nothing	1,941	37.0%
Under $200	152	2.9
$200 - $499	231	4.4
$500 - $999	456	8.7
$1,000 - $1,999	877	16.7
$2,000 - $2,999	560	10.7
$3,000 - $3,999	377	7.2
$4,000 - $5,999	377	7.2
$6,000 - $7,999	184	3.5
$8,000 or More	89	1.7
Total	5,244	100.0%

Source: California Student Expenses and Resources Survey, California Student Aid Commission Data

TABLE 20 Amount of Loans from All Sources of Guaranteed Student Loan Applicants, 1982-83

Amount	Number	Percent
Nothing	443	8.4%
Under $200	78	1.5
$200 - $499	134	2.5
$500 - $999	183	3.5
$1,000 - $1,999	753	14.3
$2,000 - $2,999	2,119	40.3
$3,000 - $3,999	462	8.8
$4,000 - $5,999	718	13.6
$6,000 - $7,999	212	4.0
$8,000 or More	162	3.1
Total	5,264	100.0%

Source: California Student Expenses and Resources Survey, California Student Aid Commission Data

TABLE 21 Prior Years' Educational Loan Debt of Guaranteed Student Loan Applicants, 1982-83

Amount	Number	Percent
Nothing	1,975	37.6%
Under $500	178	3.4
$500 - $999	133	2.5
$1,000 - $1,499	179	3.4
$1,500 - $1,999	224	4.3
$2,000 - $3,999	958	18.2
$4,000 - $5,999	666	12.7
$6,000 - $7,999	318	6.0
$8,000 - $9,999	148	2.8
$10,000 or More	479	9.1
Total	5,258	100.0%

Source: California Student Expenses and Resources Survey, California Student Aid Commission Data

CONCLUSIONS

Several facts stand out as particularly noteworthy from the data gathered by the California Student Aid Commission:

First, very little loan discrimination appears to exist against any group of students. The only exception of any magnitude to the overall 87 percent acceptance rate among Guaranteed Student Loan applicants were (1) part-time and half-time undergraduates, who had less success in obtaining loans than full-time undergraduate and graduate students -- 58 percent and 80 percent, respectively, compared to 86 and 92 percent -- and (2) Community College students whose acceptance rate was only 76 percent, compared to that of independent and proprietary institution students, at 90 and 88 percent, respectively. The reason for this latter difference is unclear, since lender policies are less restrictive for Community College students than for proprietary students, but one reason may be that Community College students require smaller loans than other students, which makes these loans less attractive to lenders. Small loans are just as costly to administer as large loans, and they also bring down the lender's average indebtedness figure that is taken into consideration when the lender sells student loan portfolios to the secondary market. Another reason for the Community College difference probably is that at the time of the survey one of California's largest lenders was not making loans to students at certain Community Colleges because of their high default rates. Now, however, most of these colleges have been reinstated by the lender.

Second, the percentage of students applying for guaranteed student loans differs substantially among the segments. Over half of California's proprietary school students and 40 percent of independent college and university students applied for these loans, compared to 30 percent at the University of California, 19 percent at the State University, and 5 percent at the Community Colleges. The reason most likely is that unlike the public segments, proprietary and independent institutions charge tuition and thus usually have higher cost of attendance than public institutions.

Third, approximately 40 percent of the students attending independent institutions and the University of California received no parental financial support for their education, despite the fact that many students in these two segments often come from affluent families. This raises the question as to whether some of these families are using guaranteed student loans to replace their own financial assistance for their children's education.

Fourth, only 23 percent of California's postbaccalaureate students applied for guaranteed loans -- a much lower percentage than in some other states, such as New York, where 61 percent of its graduate students borrow from the Guaranteed Student Loan program. In recent years, some legislative interest has been expressed in raising fees for graduate and professional students in California's public universities. If this should occur, the demand for guaranteed loans among California graduate students would increase considerably and would, in turn, increase student debt levels.

Finally, and perhaps most significantly, nearly 23 percent of California's freshmen applied for guaranteed loans -- virtually the same percentage as master's and doctoral students. If these freshmen find it necessary to continue to borrow through four years of college, they will graduate with very high debt levels. As studies by the New York State Department of Education have shown, this has the potential of increasing default rates in the future -- one topic of the next and last section of this report.

FOUR

Student Debts and Default Rates

Students obtain financial aid other than family support from federal and State agencies, educational institutions, and/or private sources in the form of loans, grants, or work-study. Loans are the only form of this aid that they have to repay, and therefore raise issues of student indebtedness and defaults.

In recent years, federal loan programs have grown rapidly in comparison with federal and State grant programs, and students are increasingly relying on loans to finance their postsecondary education. Nationally, for example, the number of students at private institutions receiving guaranteed student loans doubled between 1979-80 and 1981-82. In California, as of 1978-79, loans made up only 19.1 percent of student financial aid, with scholarships, grants, and work-study making up the remaining 80.9 percent. By 1981-82, however -- just four years later -- loans made up 50.1 percent of student financial aid, compared with 49.9 percent coming from other sources.

STUDENT DEBTS

This shift to loans as the major non-family means to finance postsecondary education is leading to high debts for students to repay after graduation. A recent survey by the Pennsylvania Higher Education Assistance Agency found that between 1976-77 and 1982-83 the average debt incurred by Pennsylvania graduate and professional students had more than tripled -- from an average of $4,882 to $15,228. Such high debts can affect both students in the form of restricting their institutional and career choices and also the loan programs themselves in the form of higher costs and potentially higher default rates.

As was shown in Part Three, 23 percent of California freshmen surveyed by the California Student Aid Commission this past spring had taken out guaranteed student loans. If they need to continue borrowing through their undergraduate years, some of them will have accumulated major debts by the time they graduate; and those who choose to continue their education into graduate or professional school may finish their programs under severe debt burdens. Whether or not they are able to manage their debt repayment as scheduled will depend on the length of their repayment period, the interest rate of their loan, and their postgraduate earnings.

In a 1980-81 national study, Flamer, Horch, and Davis found that 25 to 35 percent of arts and science graduate students surveyed had accumulated seemingly unmanageable debt burdens by their graduation. Over 80 percent of the law students surveyed had debt burdens in excess of $7,500, and about 5 percent had debts in excess of $24,000. Among fourth-year medical students, only 5.7 percent had debts of less than $7,500; 65 percent had borrowed more than $20,000; and 5.0 percent had debts in excess of $50,000 (pp. 7.6 - 7.7).

Unfortunately, similarly detailed information on student debt patterns is not currently available for California students, but these national data suggest at the very least that loans for graduate students can pose a serious problem when overused, despite their becoming an essential ingredient for many students in financing graduate and professional education.

Although educational institutions are not direct participants in the Guaranteed Student Loan program, many of their financial aid administrators are increasingly concerned about the rising debt levels of their student borrowers and are expanding or initiating programs to alert these students to their financial responsibilities and potential debt burdens and to counsel them on how to manage their financial aid obligations.

It is important that these activities be encouraged and expanded. Students must be made aware of the financial responsibility they are undertaking when they receive guaranteed student loans. Otherwise, many may incur higher debts than they can repay, and this in turn will lead to increased defaults.

DEFAULTS ON GUARANTEED STUDENT LOANS

The level of student defaults on federally backed loans has been a matter of concern to the President and Congress and has attracted much attention from the media and the public. The prevention of defaults is important not only for the current health of loan programs but also for their future. Because of the expense associated with defaulted loans, for every default that can be prevented, the government can subsidize two and one-half additional loans. Moreover, besides defaults creating more expense for the federal government, state guarantee agencies, and lenders, they erode both government and public support for student loan programs.

National Default Rates

In fiscal 1979 and 1980, the National Direct Student Loan default rate was over 16 percent, although by 1982, it had declined to 10.5 percent -- involving over 727,000 students and $675 million in defaulted loans, and not including defaulted loans turned over to the federal Department of Education for collection.

In the Federal Insured Student Loan program, as of September 30, 1982, the gross default rate was 15.3 percent, down slightly from the previous year; while the rate for the guarantee agencies in the Guaranteed Student Loan program was 9.3 percent, down from a high of 10.6 percent in 1980. By late 1982, the Department of Education had paid approximately $2 billion in defaulted claims for these programs since their inception.

Because of the growth of the Guaranteed Student Loan program and the increasing costs associated with defaulted loans, the Department of Education has initiated new procedures and regulations to bring these default rates down. For the National Direct Student Loan program, it has cut off or reduced funds to schools with default rates of 10 to 25 percent; and for all loan programs, it now sends names of defaulters who are current or retired federal employees to their agencies, which under legislation passed last year can withhold up to 15 percent of the defaulters' wages to repay their outstanding loans. The Department has notified some 47,000 federal workers and retirees that this action would be taken, and approximately 5,000 of them have repaid about $2.3 million of their loans.

In addition to these measures, the Department has proposed that (1) students who have defaulted on loans or owe refunds on grant overpayments not be allowed to receive further federal aid; (2) colleges be required to turn over delinquent National Direct Student Loan program loans to the Department sooner than the two years the colleges are currently given to collect on them; (3) state guarantee agencies provide credit bureaus with the names of defaulters; and (4) the six-year federal statute of limitations be used in the filing of lawsuits to collect defaulted loans unless a state has a longer statute of limitations.

California Default Rates

Because California's first state guarantee agency student loans were not made until 1979, repayments did not begin until 1981-82. In October 1982, the default rate was 7.7 percent. By this past August, it had risen to 9.9 percent and amounted to $43,246,292 in defaulted loans. By the end of October, it had dropped to 9.2 percent.

As can be seen in Table 22, these rates vary by segment, with private vocational schools having the highest rate of defaults at 26.5 percent. Although these schools account for only 15.2 percent of the matured loans, their students account for 40.4 percent of the default dollars. Eighty-nine of these 313 schools have a default rate of over 20.1 percent, and they account for over 60.4 percent of the default dollars among all 313.

Both the Community Colleges and private two-year schools have default rates of over 12 percent, but the private two-year schools represent only 1.8 percent of the defaults while the Community Colleges represent 14 percent. Forty of the 95 Community Colleges have default rates of 10.1 to 15.0 percent; 16 others have rates of 15.1 to 20.0 percent; and five have rates of over 21.1 percent.

The California Student Aid Commission has taken two steps to collect on defaulted loans: First, it reports the names of the defaulters to a credit bureau, which encourages defaulters to begin repayment in order to clear their credit record. Second, its offset program with the Franchise Tax Board allows it to receive any tax refunds due defaulters. This program has been in operation for only the 1982 tax year, but as of last July 31, the Student Aid Commission had received $81,240 (1.5 percent of the amount placed with the Board) from 573 defaulters. Since the inception of the program, its total default recovery rate through last August 31 had been only 3.9 percent or $1.7 million of the $43.2 million in defaulted loans.

TABLE 22 Default Statistics by Educational Segment, California Guaranteed Student Loan Program, August 31, 1983

Segment	Default Rate	Outstanding Loans	Percent of Outstandings	Matured Paper	Percent of Matured Paper	Defaults	Percent of Defaults
University of California	3.9%	$ 303,150,994	15.4%	$ 57,882,439	13.4%	$ 2,272,997	5.3%
California State University	6.4	394,990,630	20.1	85,680,733	19.8	5,485,170	12.7
Community Colleges	12.4	224,040,395	11.4	48,813,145	11.3	6,038,170	14.0
Private Four-Year	6.6	616,422,670	31.3	137,268,743	11.3	6,038,170	14.0
Vocational	26.5	257,576,799	13.1	65,967,516	15.2	17,492,136	40.4
Private Two-Year	12.7	35,462,661	1.8	9,438,719	2.2	1,200,656	2.8
Hospital	1.0	3,501,880	0.2	947,895	0.2	9,875	0.0
Out-of-State	6.2	128,692,738	6.5	25,681,078	5.9	1,610,124	3.7
Out-of-Country	7.6	6,718,983	0.3	1,043,007	0.3	79,295	0.2
Total	9.9%	$1,969,557,750	100.0%	$432,723,275	100.0%	$43,246,292	100.0%

Source: California Student Aid Commission

In an attempt to decrease further the number of defaults and prevent further ones, the Student Aid Commission is initiating new procedures and programs aimed at all three parties involved with guaranteed loans -- institutions, lenders, and borrowers. It will inform institutions whose default rates are 15 percent or higher about their own default rate, compared to the rates for their segment and the program as a whole, in order to bring their rates down; and for institutions with rates of over 25 percent, it will initiate limitation, suspension, and termination ("LST") proceedings. These proceedings involve a formal analysis of the institution's problem, after which the Student Aid Commission can, if necessary, limit loans, suspend the institution from the program for a specified period, or terminate its participation in the program entirely.

The Student Aid Commission will also inform lenders of their default rates and work more closely with them to prevent further defaults. It will encourage lenders and institutions to give student borrowers more information about and counseling on debt obligations and management, and it will expand its offset program with the Franchise Tax Board to obtain current addresses of defaulters and take defaults of less than $1,500 to Small Claims Court.

Financial Implications of the Default Rate

Because the federal government reinsures the guaranteed student loans, it ultimately bears the direct costs of defaulted loans. Guarantee agencies such as the California Student Aid Commission do not share the costs for defaulted loans if their default rate is below 5 percent, but if their rate goes over 5 percent, they will not be reinsured 100 percent and will be required to pay a portion of the defaulted loans from their default reserve fund. If the rate is 5 to 9 percent, they must pay 10 percent of the amount in default for defaulted loans in excess of 5 percent; and if it is more than 9 percent, they must pay an additional 20 percent of the amount in default for defaulted loans in excess of 9 percent.

New guarantee agencies automatically have full default reinsurance coverage for their first five years, but this coverage for the California Student Aid Commission ended this past September 30. The Student Aid Commission estimates that its coverage will drop to 80 percent in the fourth quarter of the federal fiscal year next summer. After that time, it will have to use funds from its default reserve fund to pay a portion of the defaulted loans. As of last June 30, this fund stood at $35.5 million, or 2.1 percent of all outstanding loans, and its balance is expected to range from 2.1 to 1.5 percent through 1987-88. After projecting probable draws on the fund as well as expected income from it, the Student Aid Commission anticipates no difficulty in meeting default claims in the long run; but in the short run it may face cash flow problems because of the length of time the federal government takes to process default claims.

Three options that could be considered to reduce these default rates still further involve (1) greater selectivity by excluding institutions or lenders with high default rates from the program; (2) redoubled collection efforts, by raising incentives for lenders to collect on defaulted loans and increasing sanctions against defaulters; and (3) increased prevention by improving the understanding of lenders and institutions about their responsibilities under the program and by increased counseling of student applicants on their responsibilities and potential liabilities if they receive a loan.

The California Postsecondary Education Commission has advocated that "students throughout California should be treated similarly by State financial assistance policies regardless of the institutions they attend, and the State should use a common and consistent methodology to assure equitable treatment" (1982, p. 29). Among the three options of greater selectivity, collection, and prevention, increasing selectivity by excluding certain institutions from the Guaranteed Student Loan program would be inconsistent with this policy. Therefore, the Postsecondary Commission supports the Student Aid Commission's programs to strengthen its collection and prevention efforts.

CONCLUSION

The objectives of the federal Guaranteed Student Loan program are twofold: (1) to reduce financial barriers to access into postsecondary education, and (2) to reduce financial barriers to students' choice of postsecondary education institutions. The program has come far in meeting these objectives. Since its inception in 1966, over 21 million loans totaling $35 billion have made postsecondary education possible for many students who might not have otherwise been able to attend and have broadened the choice of institutions available to them.

In California, since April 1980, the Guaranteed Student Loan program has made 750,000 loans totaling $2 billion. Despite some concerns with potentially high student-debt levels and default rates, the California program also appears to be meeting the goals of access and choice, and from the evidence available, little if any discrimination appears to exist against students on the basis of institution attended, sex, ethnicity, age, or any other personal characteristic.

31

GLOSSARY

1

NOTE: The following list defines the major terms associated with the Guaranteed Student Loan program, as used by the National Commission on Student Financial Assistance (1982).

Administrative Cost Allowance (ACA): In order to assist guaranty agencies in covering their overall administrative expenses, the federal government pays these agencies an amount equal to up to 1 percent of the principal amounts that they insure annually. Guaranty agencies apply quarterly for ACA reimbursement and must submit justifications for their requests.

Cancellation: A Guaranteed Student Loan may be cancelled, and the guarantee collected by the lender due to the death or disability of the borrower or following a borrower's settlement in a bankruptcy action.

Collection Agency: An organized business that specializes in collecting payment on defaulted or delinquent loans. Collection agencies usually bill lenders based on a percentage of the amount they collect from overdue borrowers and are most often private, profit-making ventures.

Default: A loan is considered to be in default when a borrower fails to make an installment payment when due, fails to establish a repayment plan, or violates other terms of the loan agreement such that the Education Department can reasonably conclude that the borrower no longer intends to repay the loan. Default claims are usually considered when payment is 120 days overdue.

Deferments: When a borrower meets specified conditions that enable him or her to postpone payment of loan principal and interest (e.g., for continued study, military service, certain voluntary service, disability, and other reasons). While a loan is in deferment status, the federal government continues to pay the in-school interest subsidy.

Dependent Student: A student who is considered to be dependent on his or her parents and/or guardians for support. (Also see *Independent Student.*)

Due Diligence: As applied to the GSL Program, the expectation that those involved in awarding, servicing, and collecting loans will utilize practices that adhere to the standards that financial institutions follow in administering all consumer loans.

Eligible Borrower: A student currently attending an accredited postsecondary institution on a half-time or more basis in an undergraduate or a graduate program is eligible to borrow under the GSL Program. Eligible borrowers must meet current financial or need requirements which will determine the maximum amount that they may borrow.

Expected Family Contribution (EFC): The amount calculated according to a standard need analysis formula that a family will be expected to pay toward a given student's postsecondary education. This contribution is based on family savings; parent's, student's, and/or spouse's income; non-taxable income sources; and assets. The amount of the EFC is then offset by the size of the family, the number of family members enrolled in postsecondary education, and other factors. For GSL applicants who have not received campus-based aid (i.e., NDSL, CWS, SEOG), the school is permitted to use a simplified analysis which does not include assets.

Federally Insured Student Loans (FISL): A program that provides insurance to lenders who are not adequately served by a guaranty agency. Under FISL, loan capital is made available for students under identical rules to the GSL Program in areas not served by a guaranty agency or for lending directly through academic institutions. FISL insured only 5 percent of all guaranteed loans in fiscal year 1981. This percentage has steadily decreased as states have established guaranty agencies under a program of federal incentives.

Grace Period: A period of time in which a GSL borrower does not have to repay a loan. Once a borrower graduates, withdraws from school, or falls below half-time status, the grace period begins. Repayment of a GSL does not commence until either six or nine months after the start of the grace period depending on when the loan was made and under what conditions. The in-school interest subsidy continues to be paid during the grace period.

Guaranty Agency: A state or nonprofit entity that administers the student loan insurance program in a state. Guaranty agencies serve as the middlemen in the process of locating capital to finance GSLs.

Independent Student: A student who is considered to be self-supporting under federal criteria. For the year of application for aid and the calendar year preceding it, an independent student cannot: (1) be claimed as an exemption for federal income tax purposes by his or her parents and/or guardians; (2) receive more than $750 in financial assistance from his or her parents and/or guardians; and (3) live for more than six weeks in the home of his or her parents and/or guardians. Failure to meet any of these provisions results in the student being classified as dependent. Married students, however, must only prove independence for the year of aid application.

In-school Interest Subsidy: During the time that a borrower is enrolled in a postsecondary institution on a half-time or more basis and during the grace period, the federal government pays the interest that accrues on a GSL. The in-school interest subsidy is paid directly to the lender. The student is not required to repay this subsidy.

Insurance Premium: A fee charged by guaranty agencies in order to cover a portion of default and administrative expenses. Currently, the agencies charge students up to 1 percent times the length of a student's in-school status plus the grace period, i.e., a freshman may be charged 1 percent times 4 years times 1 year grace period equals 5 percent. For loans made under the FISL program, the insurance premium is equal to one-quarter of 1 percent per year until repayment.

Loan Guarantee: The legal promise made by the federal government or the guaranty agency to repay lenders for reasonable interest and the principal amount of loans defaulted or rendered uncollectable due to bankruptcy, death, or disability of the borrower. This guarantee by the government is a key incentive for private lending under the GSL Program.

National Direct Student Loan Program (NDSL): Part of the campus-based federal student assistance programs, the NDSL[1] Program provides low interest (5 percent) loans to students of sufficient need as determined through the uniform methodology or other systems of need analysis approved by the Department of Education. NDSLs are disbursed and serviced directly by postsecondary institutions and are generally awarded in smaller amounts than Guaranteed Student Loans.

Origination Fee: As authorized in 1981, a fee that each student must pay to receive a loan. The lender subtracts 5 percent from the face value of the loan and returns it to the federal treasury as an origination fee, thereby offsetting and reducing federal payments to the lender. Borrowers are still liable for repaying the entire amount of the loan under this system set up to reduce federal costs in the GSL Program.

PLUS Loans: Created by Congress in 1980 as Parent Loans for Undergraduate Students and modified in 1981, the PLUS Loan Program (technically named Auxiliary Loans to Assist Students) offers higher (14 percent) interest loans to parents, independent undergraduate students, and graduate students. No in-school interest subsidy applies to these loans which are disbursed through non-federal lenders. Repayment of PLUS loans commences 60 days after disbursement except for full-time students who must pay only the interest at that time. Currently, the PLUS Program offers loans in only a limited number of states.

Promissory Note: The document, signed by the borrower at the time a GSL is awarded, that legally binds the borrower to the statutory terms and conditions of the loan, to repay the loan, and to use the loan funds for educationally related purposes only.

Reinsurance: The process through which the federal government insures loans guaranteed by state guaranty agencies.

Remaining Need: For purposes of determining the amount of a GSL, remaining need is defined as the difference between the total of a borrower's expected family contribution plus other forms of student financial assistance and the total cost of education. A GSL may not be issued for more than a borrower's remaining need if the family income exceeds $30,000.

Secondary Market: A means through which holders of loan notes sell them to a third party (e.g., Sallie Mae or another lending institution) for the face value of the loan portfolio or other negotiated price. Once sold, the secondary marketer is given total responsibility for the future servicing and repayment of the loan unless a warehousing agreement has been reached. (Also see *Warehousing*.)

Servicing: The activities involved in awarding and collecting loans; including: tracking borrowers while in school, billing borrowers when the loan is due, and carrying out collections activities to ensure continued repayment.

Special Allowance: The federal government pays each lender in the GSL Program a quarterly Special Allowance fee throughout the life of a loan. The Special Allowance is equal to the bond-equivalent rate on U.S. Treasury Bills minus the interest rate on the loan plus 3.5 percent and is paid on the unpaid principal balance of all eligible loans held by the lender. Its purpose is to compensate for the difference between the interest rate the lender receives and the market rate for borrowing.

Student Loan Marketing Association (Sallie Mae): A private corporation created as part of the Education Amendments of 1972 as a means for encouraging private lending under the GSL Program by providing a vehicle through which lenders could sell or borrow against their student loan portfolios. (Also see *Secondary Market and Warehousing.*)

Treasury Bill Interest Rate: As applied to the GSL Program, the average bond equivalent rates of 91-day United States Government Treasury Bills auctioned for a given quarter are used as the basis for determining the amount of Special Allowance payments to lenders. The bond-equivalent rate is the actual yield for the Treasury Bill as opposed to its discount rate.

Uniform Methodology: The most widely used system for determining and measuring the ability of a family to contribute to a given student's postsecondary education. Uniform Methodology is approved by the Department of Education and is performed by private need analysis services. (Also see *Expected Family Contribution.*)

Warehousing: The use of loans made by a lender as collateral for borrowing funds from Sallie Mae. The amount of collateral that Sallie Mae requires to enter into a warehousing arrangement varies, but will exceed the face value of the loan. Sallie Mae ensures the lender a margin of profit by tying its warehouse loan rates to the Special Allowance rate. The loans used as collateral continue to be owned by the original lender who is responsible for all servicing and collections activities.

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