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ABSTRACT

A description of the current provisions of the Guaranteed Student Loan (GSL) program is provided along with an analysis of the GSL budget, a summary of up-to-date statistics on participation in the program, and a review of continuing issues related to the program. These federally reinsured loans are usually made by private lenders to students for college expenses, and they are the largest source of federally supported student aid. The GSL program is described in terms of: regular GSLs; provisions affecting borrowers and lenders (loan limits, interest rates, repayment, deferments, borrower fees, lender, special allowance, loan disbursement, and lender of last resort); provisions affecting guaranty agencies (insurance and collection, reinsurance fee and funding); supplemental loans for students (SLS) and PLUS loans (eligible borrowers, loan limits, interest rates, repayment terms, and refinancing); and consolidation loans. Information on the GSL budget includes the GSL program as an entitlement and major elements of the GSL budget (obligations, offsetting collections, and unobligated balances). Current program data includes loan volume, average loan size, participation in the GSL program, and GSL defaults. Some of the current GSL program issues are defaults, appropriate recipients, and debt burden. Tables are included. 28 references. (Author/SM)

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87-815 EPW

CRS REPORT FOR CONGRESS

THE GUARANTEED STUDENT LOAN PROGRAM: CURRENT STATUS, BACKGROUND, AND ISSUES

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October 8, 1987

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ABSTRACT

This paper provides an overview of the structure and terms of the loans authorized by the Guaranteed Student Loan program, an analysis of the annual Guaranteed Student Loan budget, a summary of current statistics on participation in the program, and a brief review of continuing issues concerning the program. Federally reinsured and, under certain circumstances, federally subsidized, the loans under this program are typically made by private lenders to students for college expenses. These loans are the largest source of federally supported student aid, providing an estimated $9.2 billion to students in FY 1987. The issues of continuing interest for this program are the extent of defaults on loans, the characteristics of appropriate borrowers, and the debt burdens being incurred by students.

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THE GUARANTEED STUDENT LOAN PROGRAM: CURRENT STATUS, BACKGROUND, AND ISSUES

INTRODUCTION

The following paper provides a description of the current provisions of the Guaranteed Student Loan (GSL) program, an analysis of the GSL budget, a summary of current statistics on participation in the program, and a brief review of continuing issues concerning the program.

Under the GSL program, the Federal Government subsidizes and reinsures loans made by private lenders to help students meet the costs of postsecondary education. GSLs are the largest source of Federal student aid. In FY 1987, the GSL program was expected to support over $9.2 billion in loan volume to undergraduate students, parents of dependent undergraduates, 1/ graduate students, and professional students attending colleges, universities, and trade and technical schools. The Federal appropriation for that same fiscal year was slightly more than $3.0 billion. 2/

Among the issues of continuing concern in this program are the extent to which borrowers default, who are the most appropriate borrowers under this

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1/ The GSL program distinguishes between students who are to be considered financially "dependent" upon their parents and those students who are to be considered financially "independent" of their parents.

2/ As will be delineated in the section below on the GSL budget, the annual appropriation for the program meets not only the cost of new borrowing in that year, but costs associated with borrowing in prior years, as well.

program, and what are the consequences of debt burdens being incurred by students as the financing of college costs shifts from grants to loans.

GSL PROGRAM DESCRIPTION

The Guaranteed Student Loan program is authorized by title IV, part B of the Higher Education Act (HEA, 20 U.S.C. 1071, et seq.). Major provisions of part B were amended most recently in P.L. 99-498, the Higher Education Amendments of 1986 (signed into law on October 17, 1986). Since that time, technical amendments to part B were included in P.L. 100-50 (June 3, 1987).

The GSL program provides three different types of loans to support student expenses: regular GSLs, Supplemental Loans for Students (SLS), and PLUS loans. Primary among these, in terms of volume and in terms of program complexity, are regular GSLs, which are low-interest loans subsidized by the Federal Government for needy undergraduate, graduate, and professional students. All regular GSL applicants must now submit to a needs test. SLS loans and PLUS loans are non need-tested, unsubsidized loans with virtually identical characteristics, including a variable interest at market rates. SLS loans are generally available to independent undergraduate, graduate, and professional students; PLUS loans are available to parents of dependent undergraduates.

GSLs are financed by commercial and nonprofit lenders--no Federal funds provide capital for GSLs. Commercial lenders include banks, savings and loans, credit unions, and insurance companies, for example. Nonprofit lenders include postsecondary institutions or agencies designated by States. In addition, the federally chartered Student Loan Marketing Association (Sallie Mae), a private corporation, as well as State secondary markets provide liquidity for lenders to participate in the GSL program through buying their GSL loans and advancing lenders funds to invest in new student loans (called "warehousing").

Regular GSLs

The regular GSL program provides low-interest loans to undergraduate, graduate, and professional students attending colleges, community colleges, universities, professional schools, or vocational and trade schools. Program provisions affect four major participants: the borrower, the lender, the guaranty agency, 3/ and the Federal Government.

Provisions Affecting Borrowers and Lenders

To be eligible for a regular GSL, a student must be enrolled on at least a half-time basis in a participating institution of higher education; be maintaining "satisfactory progress" at that institution; 4/ not owe a refund on a grant under title IV 5/ or be in default on a student loan under the title; 6/ have on file at his or her institution a statement of educational purpose stating that the loan will be used solely for educational expenses; and be a citizen or permanent resident alien of the United States.

3/ Under the current GSL program, GSL lenders are directly insured by State or national nonprofit guaranty agencies against default. Initially, these agencies pay default and other claims to the lenders. The guaranty agencies are, in turn, reinsured by the Federal Government to which they make claim for reimbursements for their insurance payments to lenders. The Federal Government also reimburses guaranty agencies for discharges of loans due to death, disability or bankruptcy.

4/ Defined in section 484(c) of the HEA, and generally requiring a student to maintain a cumulative "C" grade average.

5/ These are Pell grants and Supplemental Educational Opportunity grants. Both are need-based grants. The former is administered nationally and students bring this assistance with them as they enroll in schools. The latter is administered at participating colleges and only students enrolled in those institutions are eligible for assistance.

6/ In addition to the loans under the GSL program, title IV authorizes the Perkins loans which are need-based loans administered at participating colleges. Only students enrolled in those institutions are eligible for assistance.

Several other provisions also affect eligibility. All applicants for regular GSLs must undergo a "need test" through which their family's or their own expected contribution to college expenses is determined. Applicants' eligibility for assistance and the amount of that assistance is calculated by comparing expected family contributions to college costs. In addition, undergraduate students must receive a determination of whether or not they are eligible for a Pell grant prior to applying for a GSL. Such a determination does not affect eligibility for a GSL, but is designed to insure that the students first receive any grant aid for which they may be eligible prior to incurring GSL debt. Finally, students attending certain foreign medical graduate schools may not be eligible for GSLs because of restrictions on the school's institutional eligibility. 7/

Loan limits. The maximum loan principal that may be borrowed annually is $2,625 for undergraduate students during their first 2 years of study, $4,000 per year for up to 3 additional years of undergraduate study, and $7,000 per year for graduate and professional students for up to 5 years of study. The aggregate loan limit for undergraduates is $17,250 and for graduate and professional students is $54,750.

Interest rates. The interest rate on new loans for borrowers of regular GSLs is currently 8 percent for new borrowers (those not having previously borrowed GSLs), or 7 or 9 percent if the GSL borrower already has outstanding GSL debt at either of these rates. Effective July 1, 1988, new GSL borrowers

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7/ To qualify as an eligible institution, the school must have at least 60 percent of its student body be nationals of the country in which the school is located. If the school does not meet this requirement, it may qualify if U.S. nationals attending the institution have a pass rate of at least 45 percent on examinations administered by the Educational Commission for Foreign Medical Graduates for the first and second years after the enactment of P.L. 99-498 (Oct. 17, 1986) and a pass rate of 50 percent thereafter.

will incur an 8 percent rate on their loans that will rise to 10 percent at the beginning of their fifth year in repayment. Under some conditions, the increase in the annual interest rate to 10 percent may raise lenders' rates of return to "excessive" levels. The authorizing statute requires lenders, in that event, to reduce borrowers' outstanding principal. (See discussion below under "Special Allowance" for more details.)

Repayment. GSL borrowers do not have to repay their loans while they are in school, and for a 6 month "grace" period thereafter. The Federal Government pays a student's interest on a loan during these periods and no payment is made on principal. Repayment by a borrower begins 6 months after he or she ceases to be enrolled at an eligible institution on at least a half-time basis; and the loan generally must be repaid within 10 years after repayment commences. The repayment period is extended, however, by any periods during which the loan is in deferment.

Deferments. GSL repayments may be deferred for limited periods to relieve a borrower of responsibility for paying principal or interest on the loan for a period during which he or she may not reasonably be expected to afford such payments. 8/ During deferment, the Federal Government pays lenders the interest on the loan. Lenders receive no payments on loan principal during deferment periods. The circumstances of, and time limits on, deferments are specified in the Higher Education Act (HEA), and include:

1) periods during which a borrower is pursuing a full-time course of study, or a course of study between half-time and full-time for which he or she obtained a GSL or other loan under part B of title IV of the HEA, or is pursuing a course of study under a graduate

8/ For a more complete discussion of GSL deferments see, U.S. Library of Congress. Congressional Research Service. Guaranteed Student Loan Deferments: A Pro/Con Analysis. Report No. 87-111 EPW, by Charlotte Jones Fraas. Washington, Feb. 13, 1987.

fellowship program or a rehabilitation training program for disabled individuals approved by the U.S. Secretary of Education;

2) no more than 3 years during which a borrower is a member of the U.S. Armed Forces, an active duty member of the National Oceanic and Atmospheric Administration Corps, or is an officer in the Public Health Service;

3) no more than 3 years during which a borrower serves as a volunteer in the Peace Corps;

4) no more than 3 years during which a borrower serves as a volunteer in VISTA;

5) no more than 3 years during which a borrower serves in a volunteer capacity comparable to service in the Peace Corps or VISTA for a tax-exempt non-profit organization;

6) no more than 3 years during which a borrower is a full-time teacher in an elementary of secondary school in a "teacher shortage area" established by the U.S. Secretary of Education pursuant to the HEA;

7) no more than 2 years during which a borrower serves as an intern as part of a requirement for professional practice or in a program leading to a degree or certificate from a institution of higher education, a hospital, or a health care facility that offers postgraduate training;

8) no more than 3 years during which a borrower is temporarily totally disabled or the borrower is unable to secure employment because of having to care for a disabled dependent;

9) no more than 2 years during which a borrower is unemployed and unable to find employment;

10) no more than 6 months during which a borrower is pregnant or caring for his or her newborn child or adoptive child as long as the borrower is not in school (but within 6 months of when the borrower was in school at least half-time) and not employed;

11) no more than 1 year for mothers with preschool age children who are entering or reentering the workforce with a wage rate no more than $1 above the minimum wage. 9/

9/ Of the deferments listed, the following are effective only for new borrowers after July 1, 1987: for half-time students, for service in the National Oceanic and Atmospheric Administration Corps, for teaching in shortage areas, for having to care for a disabled dependent, for parental leave, and for mothers of preschoolers.

Borrower fees. When a student borrows a regular GSL, he or she is liable for certain costs. Since 1981, the HEA has authorized lenders to collect "origination fees" equal to 5 percent of the loan's principal to be paid by the lender to the Federal Government in order to offset Federal in-school interest and special allo[illegible] payments (discussed below). Borrowers may also be charged up to 3 percent of the loan principal as an insurance premium to help defray guaranty agency default costs. Both the origination fee and insurance premium are subtracted from each installment payment of the loan proceeds made to the borrower by the lender. P.L. 99-498 increased the loan limit for new undergraduate student borrowers by $125 to accommodate the loan origination fee, but otherwise the costs of the origination fee and insurance premium are subject to the annual and aggregate GSL loan limits.

Lenders. Lenders of regular GSLs are most commonly banks, savings and loans, credit unions and other private lenders. They may also be pension funds, insurance companies, State agencies or nonprofit private agencies designated by States, eligible educational institutions, the Rural Rehabilitation Corporation or, under limited circumstances, guaranty agencies.

Special allowance. An important aspect of the GSL program for lenders is the special allowance payment they receive quarterly from the Federal Government to bring their profit on low-interest GSLs up to approximately a market rate. Effective for most loans made to cover the costs of enrollment on or after November 15, 1986, the special allowance rate is the sum of the 91-day U.S. Treasury bill (T-bill) average interest rate and 3.25 percent, minus the borrower's interest rate, divided by four (for a quarterly payment). For older loans, and for loans made by the South Carolina direct lender or held by the Maine secondary market, the special allowance rate is calculated by adding 3.5

percent to the T-bill rate. 10/ The special allowance is paid by the Federal Government to the lenders from the time the loan is disbursed through the entire repayment period.

If the T-bill rate plus 3.25 percent, for loans made to cover enrollment on or after November 15, 1986, is equal to or less than the borrower's interest rate, then no special allowance is paid. In that event, the law provides that, for regular GSLs on which the interest rate has risen to 10 percent (see description above under "Interest Rates"), lenders must calculate an "excess" interest payment and reduce a borrower's outstanding principal by an adjustment amount based on that "excess" interest payment. The "excess" interest rate is equal to 10 percent (borrower's interest) minus the sum of the 91-day T-bill rate plus 3.25 percent. The borrower's outstanding principal is then reduced by an amount equal to the "excess" interest rate multiplied by his or her outstanding principal, divided by 4 (calculations are made quarterly).

Loan disbursement. The law requires lenders to send loan proceeds directly to the institution of higher education and to pay its proceeds in multiple disbursements if the amount of the loan is $1,000 or more. The check or other instrument used to deliver the loan proceeds to the institution must require the endorsement of the student, and must be payable directly to him or her. The disbursements of loan installments are made on the basis of the semester, the quarter, or similar academic schedule of the institution. The law also authorizes lenders other than the holder of the loan, as well as guaranty agencies, to act as escrow agents for loan disbursements.

10/ For loans made on or after March 1, 1986 and before October 1, 1986, the annual special allowance rate is reduced by subtracting .4 percent from the calculated rate.

Upon approval of a loan, lenders must issue a statement to the GSL borrower on his or her rights and responsibilities with respect to the loan and the consequences of defaulting on the loan, including that the defaulter will be reported to credit bureaus. Before disbursement, the lender must disclose to the borrower certain detailed information such as the principal owed, any additional charges made, the interest rate, an explanation of the repayment requirements, the total cumulative balance of the loans owed the lender by the student, and the projected monthly balance (given the cumulative balance, prepayment rights, default consequences, and any collection costs for which the borrower may become liable). The lender must provide other detailed information to the borrower when the repayment period begins.

The law prohibits lenders from offering inducements for loan applications, conducting unsolicited mailings for applications, using GSLs as an inducement to a prospective borrower to buy life insurance, or engaging in fraudulent or misleading advertising. Lenders are also prohibited from practicing discrimination in their GSL credit practices on the basis of race, national origin, religion, sex, marital status, age, or handicapped status.

Lender of last resort. Finally, the law requires each State to have a lender of "last resort" to serve otherwise eligible applicants for GSLs who have been unable to secure a loan. The guaranty agency or the State agency serving as a lender is responsible for this function, but the guaranty agency may choose banks, credit unions, savings and loans, or other private lenders at their request to act as lenders of last resort.

Provisions Affecting Guaranty Agencies

Each State has an agency designated as the guarantor of GSLs to insure lenders against losses due to borrower defaults. Guaranty agencies also recruit lenders to participate in the GSL program to assure the access of students in the State to the GSL program, may act as a lender of last resort, and may provide technical assistance to lenders. 11/

Guaranty agencies are State agencies created by State Governments, private nonprofit agencies within the State, and two national private nonprofit guarantors--the Higher Education Assistance Foundation (HEAF), and the United Student Aid Funds (USAF).

For much of its first decade of existence, the GSL program included many federally insured student loans (FISLs), that is, loans issued by private lenders with direct Federal insurance. At times, fewer than half of the loans made each year in this program were directly guaranteed by State guaranty agencies with Federal reinsurance. Legislative changes in 1976 (Education Amendments of 1976, P.L. 94-482) made it more attractive for States and others to establish guaranty agencies. The last FISLs were made during FY 1984.

Insurance and collection. Guaranty agencies must insure loans made under the conditions of the GSL program for 100 percent of the unpaid principal. Lenders are primarily responsible for making collections on loans. If the loan is not collectable after the lender's due diligence 12/ in collection efforts after 180 days of delinquency, the lender submits a claim to the guaranty

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11/ See, National Council on Higher Education Loan Programs. Guaranteed Student Loan Handbook. NCHELP, Inc., 1987. p. 3.

12/ Due diligence for a lender is defined as its having followed specified procedures for attempting to secure repayment of the loan.

agency for the unpaid principal, plus interest. Once the guaranty agency pays the claim, it takes over the collection responsibilities (the loan.

As part of their reinsurance agreement with the Federal Government, guaranty agencies are also required to exercise diligence in making collections on delinquent loans including some specific procedures set forth in the law. After 270 days, the guaranty agency may file a claim with the U.S. Department of Education for reimbursement of its loss from a defaulted loan. Such reimbursement includes a payment for unpaid principal, accrued interest, and certain administrative costs. Generally, the Federal Government reimburses the agency at 100 percent. If the agency's annual default claims exceed 5 percent of the agency's insured principal, the excess is reimbursed at a 90 percent rate; if they exceed 9 percent, the excess over 9 percent is reimbursed at an 80 percent rate. The Department of Education currently reimburses guaranty agencies at an average rate of 96 percent. 13/

Even after the guaranty agency is reimbursed by the Federal Government for a defaulted loan, it is to try and collect on the loan. The guaranty agency is authorized to retain 30 percent of any collections it makes. If the State has a garnishment law, 14/ which complies with certain conditions described in the HEA, the agency retains 35 percent. The remainder from collections is sent to the Federal Government.

Guaranty agencies are also reinsured against borrower death, disability, or bankruptcy by the Federal Government. The reimbursement rate of loan discharges for these reasons is 100 percent.

13/ U.S. Department Of Education. Justifications of Appropriations Estimates for Committees on Appropriations. Guaranteed Student Loans. p. 48.

14/ Such a law would provide that employers of defaulting GSL borrowers reserve a specified portion of their salary for loan repayment.

Reinsurance fee. Under the 1986 amendments to the HEA, guaranty agencies must pay the Federal Government a reinsurance fee annually equal to 0.25 percent of the GSL volume newly insured (not refinanced or consolidated loans) by the agency during the fiscal year, or 0.5 percent of such volume if the agency's default claims exceed 5 percent of total principal insured.

Funding. Guaranty agencies are funded from a variety of sources. Federal reinsurance payments are their major source of funding followed by insurance premiums paid to the agency by lenders from borrower payments. Collections on defaulted loans are another source of funds as are investments of reserve funds.

The Federal Government issued interest-free "advances" to guaranty agencies to meet startup costs in the 1960s and 1970s. The agencies are liable to repay these advances at some future time. To date, less than 25 percent of the advances have been repaid. The 1986 amendments to the Higher Education Act require the Secretary of Education to collect $75 million in outstanding advances in FY 1988 and $35 million in FY 1989, but only from guaranty agencies considered solvent and having sufficient reserve funds.

Also, the Federal Government annually pays guaranty agencies an administrative cost allowance equal to 1 percent of all GSLs insured by that agency during the fiscal year.

Supplemental Loans for Students (SLS) and PLUS Loans

The GSL program also authorizes non need-tested, unsubsidized Supplemental Loans for Students, or SLS loans, and PLUS loans for parents. Like regular GSLs, these loans are insured through guaranty agencies with reinsurance by the Federal Government. The major characteristics of the SLS and PLUS loans are virtually identical except for eligibility requirements.

Eligible borrowers. Independent undergraduate, graduate, and professional students are eligible for SLS loans, and parents of dependent undergraduates are eligible for PLUS loans. A dependent undergraduate may be eligible for an SLS loan only if extenuating circumstances would preclude his or her parents from borrowing a PLUS loan to meet the family's expected family contribution to the student's college expenses. There is no need test for SLS or PLUS loans, and these loans may be used to help the borrower meet the expected family contribution for the Federal need-tested student aid programs. 15/

Loan limits. Eligible students or parents of dependent undergraduates may borrow up to $4,000 annually under the SLS or PLUS programs to a cumulative limit of $20,000. SLS and PLUS loans may not, however, exceed in a year an amount equal to the student's estimated cost of attendance minus the estimated financial aid that the student is expected to receive.

Interest rates. The interest rate charged borrowers on SLS and PLUS loans, made on or after July 1, 1987, is variable for each 12-month period beginning on July 1 and ending June 30 the following year. The variable rate is based on the bond equivalent rate of the 52 week T-bill plus 3.25 percent.

15/ Such need-tested assistance includes Pell grants, Perkins loans, and Supplemental Educational Opportunity grants.

There is an interest rate cap of 12 percent. If the calculated rate would have exceeded the 12 percent cap, the Federal Government pays a special allowance to lenders. Borrowers are required to pay the guaranty agency's loan insurance premium on SLS/PLUS loans (can range up to 3 percent) but are not liable for a loan origination fee.

Repayment terms. Unlike the regular GSL program, the SLS/PLUS programs require repayment on the loan to begin within 60 days after disbursement. Both student and parent borrowers have the option to have the payment deferred while the student or dependent undergraduate is attending school. All other deferments available under the regular GSL program are available to SLS (student) borrowers; parent borrowers of PLUS loans may only have payments deferred for up to 3 years if they are temporarily totally disabled or up to 2 years if they are unemployed. The Federal Government pays no interest during periods of deferral for SLS or PLUS loans. With agreement between a borrower and lender, the interest may either be paid monthly or quarterly during the deferral period or be capitalized (i.e., instead of being paid currently, interest is added to the unpaid principal, thereby increasing the borrower's total debt).

Refinancing. Lenders may refinance SLS and PLUS loans, including loans made to a student or parent borrower under the previous ALAS and PLUS programs (similar programs in effect prior to the 1986 amendments), so that a borrower who had borrowed several of these loans may have a single payment of principal and interest. The interest rate is the weighted average of the rates of the loans being refinanced; the repayment period begins with the first repayment for the most recent loan being refinanced.

Borrowers may request lenders from whom they obtained a loan under the old ALAS/PLUS programs to reissue a loan or loans so that the borrower may secure the variable interest rate. A lender may charge up to $100 to cover administrative costs of refinancing a loan, half of which is paid by the guaranty agency and half by the borrower. The insurance on the loan is unaffected by the reissuance, and borrowers may not be charged any additional insurance fee.

Borrowers unable to secure the refinancing of their loan from the original lender may seek a new loan from another lender in order to have the original loan discharged. The new loan would have the variable interest rate for SLS/PLUS loans, but the repayment period would not be extended from that of the original loan. Borrowers may be subject to an insurance premium on the new loan but not the $100 administrative cost fee.

Holders of old ALAS/PLUS loans were required to notify borrowers of the refinancing options available to them by October 1, 1987.

<u>Consolidation Loans</u>

Under the 1986 amendments to the HEA, borrowers with outstanding loan principal of at least $5,000 in regular GSLs, SLS loans (or ALAS loans), Perkins Loans (formerly called National Direct Student Loans), or Health Professions Student Loans (HPSLs) may consolidate the balance into one loan. PLUS loans are not eligible for consolidation.

Applicants for consolidation loans must either be in repayment status or in the 6-month "grace" period after they leave school, and may not be more than 90 days delinquent in loan repayments. Potential borrowers must first seek consolidation through lenders holding their loans. If none of the holders will consolidate the loans, the individual may seek consolidation through any lender having a consolidation insurance agreement with the Federal Government or with a guaranty agency. Such lenders may include the Student Loan Marketing Association (Sallie Mae), State agencies acting as lenders or secondary markets, a nonprofit private agency functioning in a State as a secondary market, banks or any other lenders eligible to make GSL, PLUS, or SLS loans except guaranty agencies, and the Rural Rehabilitation Corporation. Sallie Mae established a loan consolidation program (termed "SMART" loans) in the Spring of 1987, but no information is available on other programs that are currently operational.

The interest rate on a consolidation loan is the weighted average of the loans being consolidated, with a minimum rate of 9 percent. The borrower's interest rate on the consolidation loan is used to calculate special allowance payments to the lender on individual loans that are part of the consolidation and <u>not</u> the original interest rates of the individual loans. The repayment schedule on consolidation loans is determined by the loan balance as follows:

$5,000 up to $7,500--10 years
$7,500 up to $10,000--12 years
$10,000 up to $20,000--15 years
$20,000 up to $45,000--20 years
$45,000 and over--25 years

Repayment of the consolidation loan begins within 60 days after all holders of the loans being consolidated discharge the borrower's liability for the original loans. The deferments under the regular GSL program of attending school at least half-time, being disabled or caring for a disabled dependent (up to 3 years), or being unemployed (up to 2 years) apply to consolidation loans.

Borrowers consolidating loans are not subject to any insurance premium or loan origination fees. Borrowers are required to pay off any accrued unpaid interest on the loans being consolidated as their first installment.

GSL BUDGET

The GSL program has a separate budget account under U.S. Department of Education's appropriations legislation. The account includes funding for regular loans, SLS, and PLUS loans.

GSL Program as an Entitlement

The GSL program is an "entitlement" program, the only such program administered by the U.S. Department of Education. Under an entitlement program, any beneficiary meeting all of the eligibility requirements of the law (in this instance, lenders and guaranty agencies) is assured, or "entitled," to all program benefits authorized by the law. The program's statutory authorization constitutes a binding obligation for the Federal Government to pay the beneficiary full benefits. 16/

That the program is an entitlement program has important implications for its budget. Projections of total program costs for any given fiscal year help determine what that year's GSL budget authority, or appropriation, will be. This contrasts with non-entitlement programs for which Congress establishes budget authority levels in appropriations legislation for a given fiscal year, subject to the program's maximum authorization of appropriations if there is one, and program benefits are expanded or contracted to match available funding.

The GSL program budget authority of about $3 billion (FY 1987) constitutes over 15 percent of the entire U.S. Department of Education budget authority of $19.4 billion. Because of its size and its nature as an entitlement, in recent

16/ U.S. Library of Congress. Congressional Research Service. Manual on the Federal Budget Process, prepared by Allen Schick, Consultant, and Robert Keith. 1982. p. 133.

years both the Reagan Administration and Congress have looked to changes in the authorization for GSLs to effect budget savings for education programs. Since it first took office in 1981, the Reagan Administration budget requests have proposed major policy changes for the GSL program, as well as other student financial aid programs, generally through language in appropriations bills. Congress has not made such policy changes for the GSL program in U.S. Department of Education appropriations bills.

The budget for GSLs has, however, been affected by certain other congressional actions specifically intended to generally reduce Federal spending. Since 1981, reconciliation legislation passed pursuant to congressional budget resolutions, as well as the so-called "Gramm-Rudman-Hollings" law (The Balanced Budget and Emergency Deficit Control Act of 1985, P.L. 99-177) have produced budget savings under the GSL program from those spending levels that would otherwise have been required by prior law. These savings have been accomplished by restricting borrower eligibility through application of need tests to more borrowers, establishing new fees for borrowers, raising interest rates, and reducing special allowance rates, among other steps.

Reconciliation bills affecting GSLs included the Omnibus Budget Reconciliation Act of 1981 (OBRA), P.L. 97-35, and the Consolidated Omnibus Budget Reconciliation Act of 1986 (COBRA), P.L. 99-272. 17/ Although not specifically a budget reduction measure, the Higher Education Amendments of 1986, P.L. 99-498, made certain changes in the authorization for GSLs that conferees assumed in order to produce GSL savings by reconciliation for FY 1987, the Omnibus Budget Reconciliation Act of 1986, P.L. 99-509. Among these changes

17/ As amended by the Student Financial Assistance Technical Corrections Act, P.L. 99-320.

are expansion of need testing to all borrowers, establishment of a reinsurance fee for guaranty agencies, and reduction of special allowance rates.

Major Elements of the GSL Budget

The annual appropriation, or budget authority, necessary for the GSL program takes into account the Federal funding that is expected to be necessary, or "obligated," to implement the program minus any revenues collected by the Federal Government from non-Federal sources to offset obligations. The GSL budget is different from many other Federal program budgets because of the extent to which collections play a role in the program's budget level. Another factor affecting the GSL budget level is whether funds from previous years remain unobligated for use during the fiscal year in question. The following outlines the GSL budget elements and provides actual funding levels for 1986, the most recent fiscal year for which such data are available.

Obligations

The Department of Education separates GSL obligations into three different categories: (1) interest subsidies, (2) insurance costs, and (3) guaranty agency subsidies.

Interest subsidies include the interest benefits paid by the Federal Government for the student's interest on a regular GSL while the student is attending school at least half-time, while he or she is in the 6 month "grace period," or while the borrower is in a period of deferment. The special allowance, paid by the Government to lenders to bring the regular GSL borrower's rate up to approximately a fair market rate, is also considered an interest benefit. Budget documents characteristically show the special allowance obligation net of (that is, minus) the 5 percent loan origination fee payments from borrowers. This fee acts as an offset to interest benefits owed lenders by the Federal Government.

Insurance costs are primarily the payments the Federal Government makes to guaranty agencies or to lenders (for FISLs) to pay remaining principal and interest on defaulted loans, or to pay off loans in cases of borrower death, disability, or bankruptcy. Insurance costs also include any Federal payments to private collection agencies for attempts to collect on defaulted loans, and for Federal administrative costs.

Guaranty agency subsidies are the 1 percent administrative cost allowances the Federal Government pays guaranty agencies annually on new loan volume insured, and any advances made available to guaranty agency reserves.

For fiscal year 1986, GSL obligations under the regular program and the PLUS/SLS programs were as follows:

TABLE 1. GSL Program Obligations for Fiscal Year 1986
(in thousands of dollars)

	Regular loans	SLS/PLUS loans	All loans
INSURANCE SUBSIDIES			
Interest benefits	$1,700,000	---	$1,700,000
Special allowance, net of origination fees	429,000	---	429,000
INSURANCE COSTS			
Default claims	1,305,797	$12,410	1,318,207
Death, disability, bankruptcy claims	66,912	1,880	68,792
Contract collection	6,434	---	6,434
Administrative costs	6,214	112	6,326
GUARANTY AGENCY SUBSIDIES			
Administrative cost allowance	107,101	6,836	113,937
Advances for reserves	15,335	471	15,806
TOTAL	3,636,793	21,709	3,658,502

Source: Office of Management and Budget. Budget of the United States Government Fiscal Year 1988. Appendix.

Interest benefits, the special allowance payments, and default claims are characteristically the major cost items for the GSL program and constituted the largest proportion of GSL obligations in FY 1986. The extent to which the special allowance will continue as a high cost item will vary because these payments are a function of the U.S. Treasury Bill rates. 18/ Interest benefits

18/ According to the Congressional Budget Office, a 1 percent change in the average T-bill rate currently adds or subtracts $500 million from GSL program costs.

and default claims have greater stability as high cost factors, with the former being influenced by new loan volume, and the latter by the volume of loans in repayment.

Offsetting Collections

GSL obligations are reduced by certain types of repayments that are made from non-Federal sources for previous Federal GSL program expenditures. These offsetting collections are primarily borrower repayments on defaulted loans resulting from Federal Government collection efforts or such efforts of guaranty agencies. Guaranty agencies reimburse the Federal Government with 65 or 70 percent of any collections (the lower percent if the State has enacted a statute to garnish defaulters' wages) they make on loans for which they had received Federal insurance reimbursements.

Under a 2-year pilot program, the U.S. Internal Revenue Service has withheld income tax refunds owed to known loan defaulters to apply against the payments due the Federal Government on their defaulted loans. These are also counted as offsets against the GSL budget. Legislation is pending in the 100th Congress (S. 685 and H.R. 2367) to amend the Deficit Reduction Act, to make the IRS offset permanent. Otherwise, it expires in December 31, 1987.

Another offsetting collection is guaranty agency repayment of Federal advances made in previous fiscal years to help the agency build its reserves. These interest-free advances have totalled nearly $200 million since 1965 and less than a fifth of this amount has been repaid. The Higher Education Amendments of 1986, P.L. 99-498, requires guaranty agencies to repay $75 million in loan advances in FY 1988 and $35 million in FY 1989, which will offset GSL obligations in those years.

With the enactment of P.L. 99-498 (October 17, 1986), guaranty agencies are liable for a reinsurance fee to be paid to the Federal Government, which will act as an offset to Federal insurance obligations.

For fiscal year 1986, GSL offsetting collections were as follows:

TABLE 2. Offsetting Collections from Loans for Fiscal Year 1986 (in thousands of dollars)

	Regular loans	SLS/PLUS loans	All loans
DEFAULTED LOANS REPAID			
Federal collections	$65,983	---	$65,983
Offsets against Federal taxes	90,729	$160	90,889
Reimbursements from guaranty agencies	168,160	602	168,762
OTHER COLLECTIONS			
Advances repaid	7,020	780	7,800
Reinsurance fees*	---	---	---
TOTAL	331,892	1,542	333,434

*Not yet implemented. Reinsurance fees were instituted by the Higher Ed cation Amendments of 1986.

Source: Office of Management and Budget. Budget of the United States Government Fiscal Year 1988. Appendix.

The extent to which offsetting collections act to reduce Federal obligations under the GSL program is largely a function of Federal and guaranty agency collection efforts. As previously noted, however, recent amendme s to the Higher Education Act had specific provisions to enhance collections, and this is likely to continue to be an area considered for change when Congress seeks budget reductions in the GSL program.

Unobligated Balances

A third factor that is considered in determining appropriations for the GSL program is any unobligated funding that may remain from previous years that may be used in the new budget year to offset obligations. For FY 1986, the unobligated balances were:

(1) Recovery of prior year obligations--$48,823,000

(2) Unobligated balance available, start of year--$68,471,000

(3) Unobligated balance available, end of year--$58,167,000

Budget documents separate unobligated funds into three separate categories. The first is called "recovery of prior year obligations," which represents revenues from previous years coming into the program that were not counted in earlier budgets. In FY 1986, $48,823,000 was recovered from prior years' obligations. This category is only pertinent to budget years that have passed or are current, because these data would be unknown for a future budget year (i.e., in the budget documents for FY 1988, the data is actual for FY 1986 and estimated for FY 1987 but unknown for FY 1988).

The second category of unobligated funds is called "unobligated balance available, start of year." This means the amount of unobligated funding from the previous year's budget available at the beginning of the budget year in question for use in that budget year. For example, in FY 1986, the unobligated balance at the start of the year was $68,471,000, which means this amount remained from the FY 1985 appropriation for use in FY 1986.

The final category of unobligated funds is the "unobligated balance, end of year." This is the amount left over from the current budget year's appropriation that is transferred, or made available, the following budget year. In FY 1986, the unobligated balance at the end of the year was $58,167,000, which was transferred to FY 1987 to offset obligations that year as the "unobligated balance available, start of year."

Obviously, some years there may be no unobligated funding or, in fact, the program could be operating with insufficient funding. If insufficient funding is anticipated for the program in a fiscal year, then a supplemental appropriation would be necessary, or some program changes to reduce anticipated obligations.

CURRENT PROGRAM DATA

Currently, complete statistics on GSL program operations are available for FY 1986 (academic year 1985-1986), with some estimated data available for FY 1987. Unless otherwise noted, the source of the data was the appendix for the U.S. Budget for Fiscal Year 1988 or the U.S. Department of Education's Budget Justifications for 1988 (unpublished).

Loan Volume

GSL loan volume data shows the amount of principal insured through lender commitments to borrowers. In FY 1986, GSLs accounted for close to 60 percent of all U.S. Department of Education aid available to students.

Recent annual loan volume (loans committed in a given year), in billions of dollars, is as follows:

	FY 1986 actual	FY 1987 estimated
Regular GSL loans	$8.050	$7.918
SLS/PLUS	.520	1.328
TOTAL	$8.570	$9.246

An influence on the increases in loan volume between the 2 fiscal years shown is likely to be the increase on loan limits authorized by P.L. 99-498. The growth in the percentage of total GSL volume consisting of SLS/PLUS borrowing (14.4 percent in FY 1987, up from 6.1 percent in FY 1986) may be a result of P.L. 99-498's requiring all regular GSL applicants to undergo need analysis, reducing the amount of regular GSL principal some applicants could borrow or denying them eligibility altogether. SLS/PLUS loans do not require a need test.

Cumulative GSL (regular and SLS/PLUS) loan volume from the program's inception through FY 1986 was $67.6 billion. About $7 billion of this was insured directly by the FISL (Federally Insured Student Loans) program which ceased to operate in July of 1984. The remainder was reinsured by the Federal Government through guaranty agencies. Clearly, not all of the cumulative loan volume has been fully repaid. The cumulative loan volume outstanding as of the end of FY 1986 was $37.5 billion, a little more than half of this consisting of loans not in repayment because of the borrower's in-school or deferment status, and a little less than half consisting of loans in repayment.

Average Loan Size

The average loan size in a given year is the average amount of loan principal borrowed by a certain category of students. In FY 1986, the average loan size was (actual data):

	FY 1986 average loan size
Regular GSL Loans	
Undergraduate students	$2,193
Graduate students	$3,304
SLS/PLUS Loans	
Students	$2,640
Parents	$2,639

Participation in the GSL Program

GSL participation data measures the number of loans committed in a given year, rather than the number of borrowers. The following are the most recent annual data on the number of loan commitments.

	1986 actual	1987 estimated
Regular GSL loans	3,242,000	3,338,000
SLS/PLUS loans	191,000	423,000
TOTAL	3,433,000	3,761,000

Students attend about 8,000 colleges, universities, and vocational schools that are eligible to participate in the GSL program. About 13,000 banks and other lenders provide GSLs to students.

GSL Defaults

A defaulted loan is a regular GSL, SLS, or PLUS loan on which the Federal Government has been required to pay an insurance, or reinsurance, claim because the borrower has been delinquent in meeting required principal and interest payments for at . t 180 days for a loan with monthly payments, or 240 days for a loan with less frequent payments. The volume of principal outstanding on defaulted loans, as of the end of FY 1986, was $4.024 billion.

The U.S. Department of Education considers two types of default rates as the best measures of long-term default costs. The gross default rate is the quotient of the cumulative program defaults for all years divided by the cumulative loans that have entered repayment (or "matured"). The net default rate reduces cumulative defaults by cumulative collections, which is then divided by cumulative matured loans. By the end of FY 1986 the gross default rate was 12.4 percent and the net default rate was 9.4 percent. 19/

Another measure of defaults is the annual default rate, which is more comparable to such rates cited by commercial lenders. This rate is the year's defaults divided by the average amount of loans in repayment during the year. In 1986, this rate was 7.6 percent.

19/ These rates are based on the sum of Federal insurance payments made directly to lenders (FISL program) and Federal reinsurance payments made to State guaranty agencies. If the rates were based only on insurance payments made directly to lenders (FISL program and State guaranty agency payments to lenders), the default rates would be slightly different--12.7 percent gross rate and 9.5 percent net rate--due, in part, to the lag in Federal reinsurance payments to guaranty agencies and the less than 100 percent reimbursement rate for guaranty agency losses. (These rates are based on unpublished data provided by the Department of Education.) The rates in this footnote and those in the text include all GSLs (regular GSL, SLS, and PLUS loans).

CURRENT ISSUES FOR THE GSL PROGRAM

The GSL program has undergone a number of changes since its inception in 1965. While the program began as a short-term Federal effort to influence the development of private loan capital for postsecondary students, it has grown to be a cornerstone of today's student financial aid options. Certain questions have dominated policy debates on this program since its inception:

(1) Who is to be eligible to borrow?

(2) How much is that borrowing to cost the Federal Government?

(3) What is the proper relationship between grants and loans in financing postsecondary education?

Today those questions are being debated in the context of three issues:

(1) Defaults and collections on defaults.

(2) The most appropriate student population to have access to GSLs.

(3) The consequences of the growth in students' debt burden.

Defaults

To some extent the GSL program is a bargain, providing an estimated $8.6 billion in aid to students in FY 1986 when approximate Federal obligations for that same fiscal year were approximately $3.7 billion. However, as has been delineated earlier, there can be substantial future costs associated with that level of borrowing, and, in particular, one source of those future costs--defaults--has proven particularly troubling to policymakers and program administrators.

The net default rate--defaulted loan volume minus collections over total matured paper--has actually remained relatively stable since FY 1981, ranging from 9.7 percent that year, to the low 8 percent range in FY 1982 and FY 1983, and back up to 9.4 percent in FY 1986. Default costs, however, have risen considerably on an annual basis from about $235 million in FY 1981 to $1.3 billion in FY 1986. This results from the application of relatively stable default rates to the dramatically increasing loan volume in repayment.

Are the current default rates a sign of a program in trouble? It may be unrealistic to expect GSL defaults to compare favorably to typical consumer loan default rates. The GSL program serves a high risk population--persons who are young, low income, and without a credit history--that would otherwise not have access to loans. The stability of those default rates in recent years suggests the presence of relatively effective default prevention or reduction procedures. It might also be kept in mind that the relative costs of defaults may not be considered excessive by some in light of the immediately incurred cost of providing a comparable level of grant assistance. Further, it might be argued that some level of defaults are a cost of doing business, in part because efforts to reduce default rates may have adverse consequences for access to loans by certain kinds of borrowers attending certain kinds of schools. Also, if such default reduction efforts imposed increased administrative burdens on lenders, the capital made available for borrowing might be diminished.

Nevertheless, there do remain many questions regarding an acceptable default rate, acceptable costs of defaults, and more appropriate and effective policies to prevent defaults and improve collection practices. The stability of default rates suggest that default reduction procedures have reached a plateau, raising the possibility that new and different procedures might now be needed. Further, the overall GSL default rate masks the fact that different kinds of schools (for example, 4 year private colleges as compared to proprietary vocational institutions), and different kinds of borrowers (for example, those from families with middle or above income as compared to those from low-income families, or those who complete only their freshman year as compared to those who persist) appear to have substantially different default rates. 20/

Efforts to address default rates might be focused on those kinds of students and institutions experiencing the highest default rates. The risk, clearly, is that such efforts will affect access to student assistance, in particular, and to higher education, in general. There may be ways to target the potentially high default schools and borrowers that do not decrease the access of certain parts of the postsecondary community to loans (e.g., more effective exit interviewing).

One set of researchers has criticized the incentives in the GSL program encouraging lending, particularly as they may affect poorer students. Wilms et al. posit that the program, "powered by artificial incentives to get lenders, schools, students, and their parents to participate, in fact may be stacked against low income students because it makes borrowing so easy and painless." 21/ They suggest considering more grant assistance and less loan assistance for students with those background characteristics that signal a higher propensity for defaulting. The Higher Education Amendments of 1986 appear to have taken this approach somewhat, by providing a lower annual borrowing limit to undergraduates during their first 2 years of study, while at the same time raising the annual Pell grant levels.

20/ Wilms, Wellford W., et al. Whose Fault is Default? A Study of the Impact of Student Characteristics and Institutional Practices on Guaranteed Student Loan Default Rates in California. Educational Evaluation and Policy Analyses. Spring 1987. p. 41-54; Joe L. McCormick. The Default Rate Factor: Who is Really at Fault? Journal of Student Financial Aid, winter 1987, as inserted in the Congressional Record (daily edition) by Representative William D. Ford, May 18, 1987, p. E1949-E1952.

21/ Wilms, Wellford W., et al. Whose Fault is Default? A Study of the Impact of Student Characteristics and Institutional Practices on Guaranteed Student Loan Default Rates in California. Educational Evaluation and Policy Analyse , spring 1987. p. 51.

Appropriate Recipients

As was clear from the discussion above, intimately related to the default issue is the issue of which students should be the recipients of GSLs. Although the program was initiated in 1965, in part, as a source of aid for middle-income students during a period of rapidly rising college costs, over time it served growing numbers of needy, low-income students. Legislation in the late 1970s (principally the Middle Income Student Assistance Act, P.L. 95-566) opened the program to all students, without consideration of need. Who should the program serve today?

For the time being, the Higher Education Amendments of 1986 may have answered that question by requiring all applicants for GSLs to undergo need analysis. This appears to have eliminated many middle-income students from GSL eligibility, and brought the program full-circle from the mid 1970s. 22/ In 1986, the desire to limit future increases in GSL volume and accompanying program costs appears to have prevailed over the access of many middle-income students to federally subsidized student loans. (Such borrowers and their parents may have access to unsubsidized SLS or PLUS loans.) In addition, it has been argued that in a period of serious budgetary constraints, it is appropriate to focus Federal student aid dollars on the neediest students.

Nevertheless, in light of the current controversy over the rate of increase in college costs, the causes of such increases, and the effects they may have on access to postsecondary education for some persons, the issue of who is

22/ Wilson, Robin. Changes in Guaranteed-Loan Program Are Slashing Sizes of Loans and Number of Students Eligible. The Chronicle of Higher Education, Sept. 9, 1987. p. A31-A32.

to borrow under the program remains alive. 23/ One key dilemma is how to reconcile the use of student borrowing to meet rising costs with the impact such borrowing may have on college costs. There is some concern that the most recent rates of increase in college costs may be placing some institutions beyond the reach of students who lack broad access to loans. At the same time, some who are engaged in the ongoing debate over college costs assert that the growth in Federal student loans and grants have fueled rising college costs, by ameliorating enrollment declines that would otherwise accompany college costs that outstrip inflation. 24/ Additionally, recent GSL policy changes to define who is to borrow may raise another policy dilemma--default rates and associated costs may rise concurrently with the targeting of loans on low-income, higher risk students, who may be more likely to default.

Debt Burden

In the 1980s there has been a shift in the extent to which student assistance is composed of borrowing, as contrasted to grants or work earnings. Loans being made under the GSL program constitute students' primary source of borrowing. When all types of student aid are taken into account--Federal, State grant programs, and institutional aid--loans now account for 50 percent of available aid, while grants 47 percent (estimated for 1985-1986 academic

23/ See, for example, Fiske, Edward B. Tuitions at New Peak, Heating Cost Debate. New York Times, May 12, 1987, p. A1, B7; Evangelauf, Jean. Increases in College Tuition Will Exceed Inflation Rate for Seventh Straight Year, The Chronicle of Higher Education, Aug. 12, 1987, p. 1, 32; Fuming of College Costs, Newsweek, May 18, 1987, p. 66-71; Hauptman, Arthur and Terry Hartle. Tuition Increases Since 1970: A Perspective, Higher Education and National Affairs. Feb. 23, 1987, p. 5-8.

24/ See, for example, Carnes, Bruce M. The Campus Cost Explosion. Policy Review, spring 1987, p. 68-71.

year). In the 1980-1981 academic year grants provided 56 percent of aid and loans provided 41 percent. 25/

Many observers of student aid perceive possibly negative consequences of this shift in emphasis to loans. Primary among their focuses are the potential effects of students' debt burden. 26/ The average cumulative indebtedness of undergraduates borrowing in 1985-86 ranged from $3,303 (borrowers in public 2-year institutions at the end of their second year) to $8,950 (borrowers in private 4-year institutions at the end of their fourth year). These debt burdens include loans from all sources, not just the GSL program. 27/

Concern is raised about the willingness of disadvantaged minority students to undertake substantial debt burdens. Other issues that have attracted attention include whether debt burden will influence or govern career choice; whether debt burden will discourage otherwise able students from pursuing costly graduate or professional studies; whether borrowers' behavior as consumers in the future will have adverse economic consequences for the country (e.g., will student debt burden affect borrowers' willingness or ability to

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25/ The College Board. Trends in Student Aid: 1980-1986. Washington, 1986. p. 8.

26/ U.S. Library of Congress. Congressional Research Service. The Cumulative Educational Debt of Postsecondary Students: Amounts and Measures of Manageability. Report No. 84-585. by James B. Stedman. Washington, Mar. 19, 1984; Hansen, Janet S. Student Loans: Are They Overburdening a Generation? The Washington Office of the College Board, Feb. 1987.

27/ Hansen, Janet S. Student Loans: Are They Overburdening a Generation? The Washington Office of the College Board, Feb. 1987. Table 2. p. 6.

undertake substantial debt to purchase a home); and, finally, what influence will debt burden have on GSL default rates. 28/

The College Board recently examined these issues concerning student debt burden, but could reach no firm conclusions. It summarized,

> Structuring effective and efficient student loan programs requires attention to many issues in addition to the burden of indebtedness, though we must not neglect the latter. We also need to consider the implications of our growing reliance on loans as the central feature of Federal efforts to promote educational opportunity and the appropriateness of loans for different kinds of students in different kinds of institutions. We should also look at whether the evolution of GSL from a minimally subsidized loan of convenience to a highly-subsidized loan for the financially needy is a backward step to the extent that it limits access to loans for students whose primary need is not subsidies but a means to invest in their own futures. 29/

28/ With regard to this last issue, some analyses have found that those with the largest debts are somewhat less likely to default since they are more likely to have completed a significant number of years of school. Thus, arguably, they are in a better position to secure employment enabling them to repay their loans. See discussion in Joe L. McCormick, The Default Rate Factor: Who is Really at Fault? Journal of Student Financial Aid, winter 1987, as inserted in the Congressional Record (daily edition) by Representative William D. Ford, May 18, 1987, p. E1949-E1952.

29/ Janet S. Hansen. Student Loans: Are They Overburdening a Generation? The Washington Office of the College Board. February 1987. p. 37.