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ABSTRACT

A series of recommendations is presented for reducing default rates in the Guaranteed Student Loan (GSL) program. First, a summary is provided of trends toward the increasing dependence of students on loans to finance their college education and the large and growing default rate among borrowers. Next, four issues are discussed: Should lenders bear greater responsibility for the GSL default problem? Should educational institutions be held accountable for the default rates of their students? Should educational institutions be given a role in deciding who can borrow? And, are there alternatives for providing aid to some high-risk students? Following analyses of these issues, recommendations and proposals are put forth, calling for: (1) the assignment of increased accountability to GSL lenders by requiring, for example, lenders to perform pre-loan counseling related to the cost of borrowing, repayment obligations, and the consequences of defaulting on a loan; (2) increasing the authority of colleges to determine whether students should be permitted to enter into a loan agreement by authorizing them to assign a risk-factor rating to applicants and allowing them greater discretion in certifying loan applications; and (3) increasing the effectiveness of work-study programs as an alternative to loans for low-income students. The recommendations of the Financial Aid Policy Task Force are appended. (AJL)

RECOMMENDATIONS FOR REDUCING THE DEFAULT RATE IN THE GUARANTEED STUDENT LOAN PROGRAM

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Agenda Item 11
Board of Governors
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Board of Governors
California Community Colleges
March 9-10, 1989

RECOMMENDATIONS FOR REDUCING THE DEFAULT RATE IN THE GUARANTEED STUDENT LOAN PROGRAM 11

Third Reading, Action Scheduled

Background

This item presents, for Board action, proposals for the reduction of default rates in the Guaranteed Student Loan (now called the Stafford Loan) Program. In January, the Board of Governors heard the recommendations of the Financial Aid Policy Task Force, which suggest short- and long-term actions at the district, State, and federal levels to:

1. Increase penalties for students who default;
2. Improve the retention and academic success of borrowers;
3. Further the monitoring and counseling of borrowers to avoid technical defaults; and
4. Increase the availability of alternative forms of aid for students who are high-risk borrowers.

Action on the recommendations was deferred until the March 1989 meeting.

The Task Force also recommended that the Board respond to a Notice of Proposed Rulemaking (NPRM) issued by the U.S. Department of Education, which would enact regulations to hold educational institutions responsible for the default rates of their students and impose severe penalties on those with default rates above 20 percent in 1990.

Because the NPRM carried a response date of February 28, 1989, the Chancellor was directed to write to the Secretary of Education expressing the Board's concern about the student loan default problem and promising further comment on the proposed rules following anticipated Board action in March. Board members have received copies of the letter, dated February 10, 1989.

The Analysis below briefly summarizes issues raised at the January 1989 meeting and presents staff recommendations for Board consideration in conjunction with the Task Force recommendations contained in the Appendix. A fuller discussion of the issues follows the Analysis section.

Analysis

The Stafford Loan (SL) program is a cooperative venture of federal and state agencies, private lenders, and educational institutions to provide students with resources to pursue postsecondary education. The students themselves are members of this partnership; they have an obligation to repay the loans. The role of each party in the SL program is delineated in federal statutes and regulations.

Recent focus on the GSL/SL default rate has precipitated questions about the assignment of responsibility for controlling defaults in relation to the assignment of authority for making loans.

Principle blame for student defaults currently is being placed on educational institutions. The colleges are willing to do more to try to prevent defaults, but lack the authority to deny loans to eligible students and the resources to expand current activities in this area. Lenders are in a position to reduce defaults by exercising greater discretion in lending, but there is no incentive for them to do so under the program's current structure. Students who meet all criteria for grant and work study aid are offered loans instead, because insufficient resources are available for alternative types of aid.

To work towards a balance between the assignment of responsibility for controlling defaults and the locus of authority in lending, and to strengthen the ability of all involved parties to more effectively avoid defaults, staff recommends that the Board of Governors:

1. Direct the Chancellor to initiate discussion with the Executive Director of the California Student Aid Commission to explore proposals for assigning more accountability to SL lenders in preventing defaults. Specific proposals might include:

    - Requiring lenders to perform pre-loan counseling, supplemental to that offered by the educational institution, that focuses on the cost of borrowing, repayment obligations, and the consequences of failing to repay a loan.

- Requiring lenders to maintain monthly or bimonthly contact with each borrower throughout the life of the loan.

- Encouraging the U.S. Department of Education to seek statutory authority to pay loan guarantees at less than 100 percent if evidence prevails that a lender is making insufficient effort to limit defaults.

2. Direct the Chancellor to further explore with the Executive Director of the California Student Aid Commission proposals for increasing the authority of educational institutions to determine whether students should be permitted to enter into a loan agreement. Specific proposals might include:

   - Authorizing colleges to assign a risk-factor rating to each prospective borrower as an advisory notice to lenders.

   - Encouraging the U.S. Department of Education to seek statutory authority to give colleges veto power over loans offered to their students, pursuant to the actions of an institutional loan review committee and based upon pre-determined criteria.

   - Encouraging the U.S. Department of Education to authorize greater institutional discretion in certifying loan applications, to the extent permitted under existing law.

3. Encourage action at the federal, State, and district levels to increase the effectiveness of work-study programs as an alternative to loans for low-income students by:

   - Directing the Chancellor to seek federal action to authorize colleges to selectively deny loans to students who are able to work, to the extent that work-study funding is available to meet their financial need.

   - Seeking federal initiatives to eliminate the matching requirement for on-campus College Work-Study placements at nonprofit institutions.

   - Seeking additional State funding for the community colleges that could be used to: (a) reinstate or strengthen job-placement and job-development offices and (b) increase wage-rates for work-study students; and encouraging districts to give these priority as funding allows.

   - Encouraging districts to participate in community- or employer-based consortia to explore job-placement opportunities for work-study students.

   - Encouraging districts to take advantage, where practical, of Job Location and Development funding available as part of their College Work-Study program allocations.

Recommended Action

That the Board of Governors adopt any or all of the recommendations as presented.

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Reducing Student Loan Defaults

Policy Options for Realigning Authority in Lending with Responsibility for Default Prevention in the Stafford Loan (Guaranteed Student Loan) Program

Synopsis of the Problem

The 1980s have been a decade of dramatic shifts in the character of financial aid provided to low income students. In 1979-80, 65 percent of the financial aid received by community college students in California was in the form of need-based grants and 24 percent in work-study. Loans, which totaled $10 million, comprised only 9 percent of all aid. Two years later, during 1981-82, California community college students borrowed *more than $90 million* from the GSL program alone. Grants declined to about one-third of total aid and work-study to 15 percent. College financial aid offices were besieged with GSL applications and were required, by federal law and regulations, to certify them for any student enrolled in good standing for six or more units.

Alarmed by this surge of loan applications, financial aid administrators found themselves in the difficult position of being hampered by federal policy – which made the loans by far the easiest type of aid to obtain and gave colleges no authority to deny GSLs to enrolled students – in their efforts to put any controls on student borrowing. To discourage inappropriate borrowing, they used any means they could legally justify, such as requiring students to fill out the Student Aid Application for California, applying satisfactory academic progress standards required for other aid programs to GSL applicants, and mandating participation in extensive counseling sessions as preconditions for certification of a loan application.

Community college efforts, although frequently at odds with the actions and instructions of the U.S. Department of Education, the California Student Aid Commission, lenders, students and parents, were effective from the first. As Figures 1 and 2 that follow show, the number and volume of GSLs to community college students have declined every year, from 1982-83 to the present, counter to state and national trends. In 1987-88, only 17,000 community college students took out GSLs, for a total of $32 million, representing a 56 percent reduction in the number of loans and a 64 percent decline in dollar volume over a period of six years. Sharp declines in dollar amounts in 1986-87 and 1987-88 reflect the impact of statewide default prevention initiatives and more restrictive federal eligibility criteria, both aggressively implemented by community colleges.

Figure 1

California GSL Annual Volume by Segment
1978-79 to 1987-88
(In Millions)

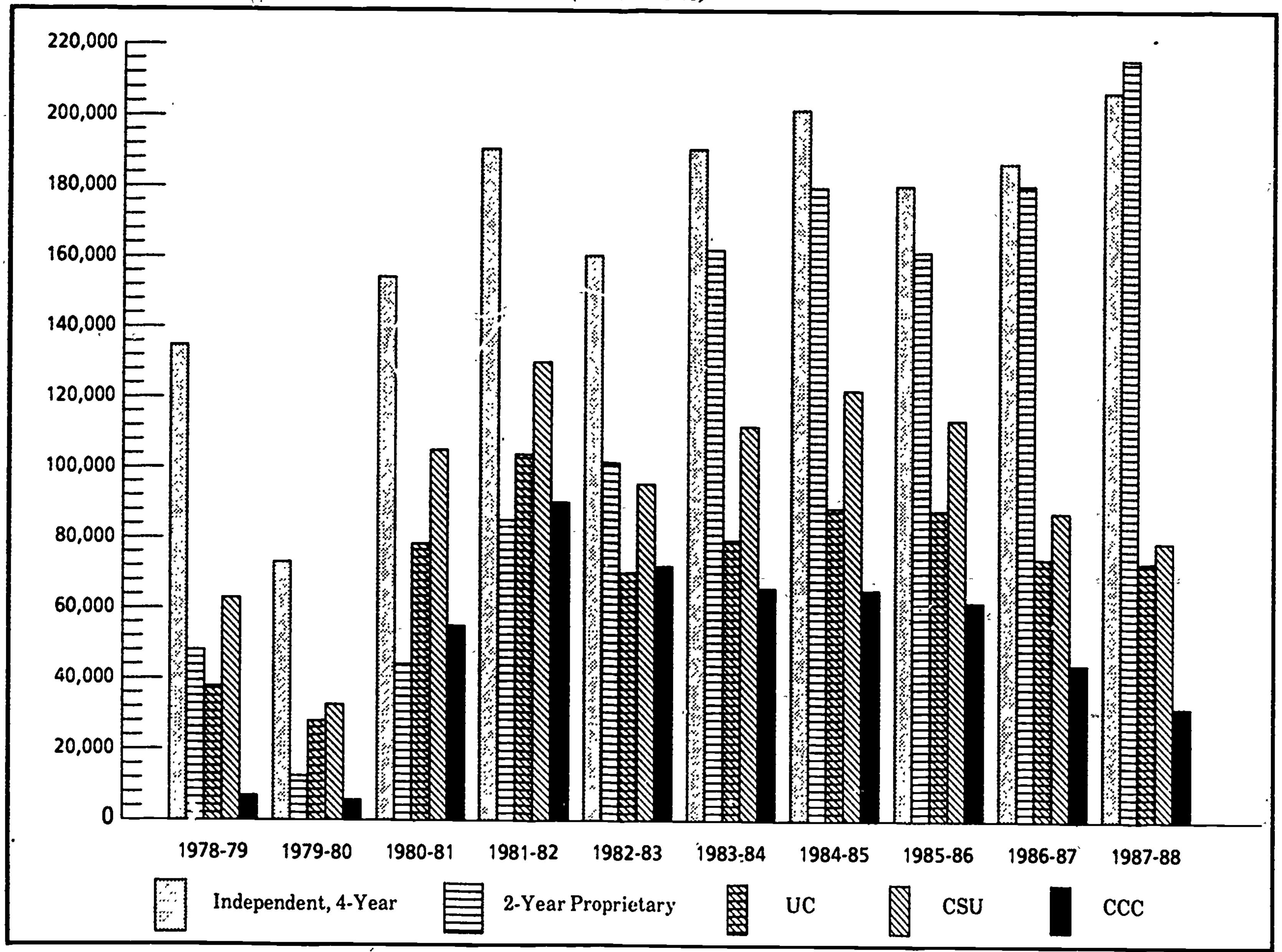
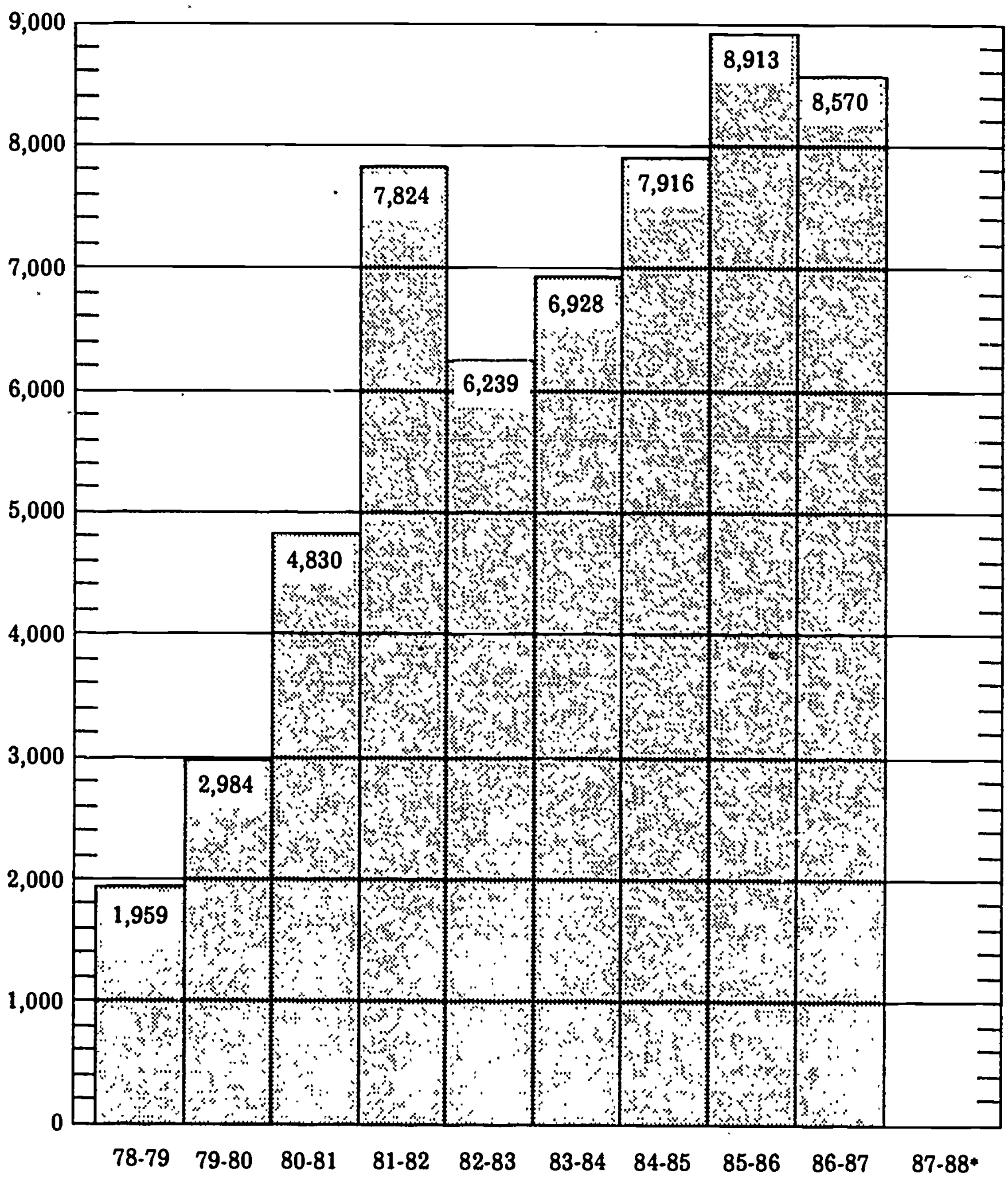


Figure 2
National
All GSLs
(In Billions)



* Data for 87-88 not available.

The cumulative gross default rate for the community colleges has grown and currently stands at 33.1 percent. This would appear to indicate a still-growing default problem, but a closer analysis of annual loan activity shows that the opposite is true. The default rate represents a total of 46,868 students who have defaulted on their loans since the beginning of the program. Figure 3 shows the year in which each of those who defaulted took out their last loan. Nearly one-quarter of all defaults are on loans made in 1981-82 alone, the same year that community college borrowing peaked. Eighty-four percent of all defaults are on loans taken out prior to 1985. The percentage of new loans that have eventually entered default has decreased each year since 1984-85. This data would indicate that, while not solved, the community college default problem has been reduced substantially.

Figure 3

California Community Colleges
Guarenteed Student Loan Defaults
by Year of Last Loan

1979-80 to 1987-88

Year	Number of Loans Made	Number of Borrowers who Defaulted	Defaults as % of Loans Made
1979-80	3,586	148	4.1
1980-81	26,680	4,009	15.0
1981-82	38,675	10,777	27.9
1982-83	32,415	8,808	27.2
1983-84	29,960	9,229	30.8
1984-85	30,113	6,607	21.9
1985-86	28,598	4,826	16.9
1986-87	21,346	2,230	10.5
1987-88	16,874	234 *	--
Total	228,247	58,000 **	20.5

Source: California Student Aid Commission, Educational Loan Programs Database.

* Defaults to date for 1987-88. Percent not calculated because number will increase as additional loans come due. Data for 1986-87 should also be considered incomplete at this time.

** Represents total number of defaulted loans. Yearly figures represent unduplicated number of student borrowers who took out their last loan that year and eventually defaulted.

State and national studies have found that a large percentage of students who default come from households with incomes below $10,000 per year and take out only one loan, suggesting that they are enrolled for one year or less. Research has also shown that a large percentage of those who default are unemployed at the time their loans come due and unable to make the payments. The stereotype of a successful professional refusing to honor his student loan obligations has become a media cliché, but applies to a very small population. The vast majority of borrowers do repay their loans, including even a majority of community college borrowers who fit the profile of defaulters.

Issues of Concern to the Board

Issue 1: *Should Lenders Bear Greater Responsibility for the SL Default Problem?*

Lenders make SLs because they are guaranteed profitable. Not only is repayment guaranteed, but lenders are paid interest and a special allowance until the loans come due, as an incentive for participation in the program. The cost of these subsidies is not inconsequential. In 1986, lenders were paid *$2.4 billion* in interest and special allowance subsidies, an amount that represented 73 percent of the total $3.3 billion federal appropriation for the GSL program that year. *Every dollar in private capital loaned to students cost almost 50 cents in federal public funds for lender subsidy and default costs.*

An expectation of greater lender responsibility for controlling defaults is certainly justifiable, given their fundamental role in the lender-borrower relationship and given the compensation they receive for participating in the program. Whether lenders are willing to accept that responsibility is another question, however.

Under the current structure of the SL program, there are few incentives for lenders to exercise discretion in lending or to be diligent in collection. U.S. Department of Education oversight of lenders is minimal. A report by the General Accounting Office (GAO) in 1988, *Guaranteed Student Loans: Lenders' Interest Billings Often Result in Overpayments*, indicated that fewer than 500, or 3.6 percent, of the 14,000 lenders participating in the GSL program in 1986 underwent on-site reviews by the Department. The reviews that were conducted consisted of examinations of "about 30 judgmentally selected accounts at each lender" (p.4) to determine whether interest and special allowance billings to the Department were substantiated. The GAO's own investigation sampled more than 2,000 accounts for 16 of the largest lenders in the program, collectively representing 11 percent of total loan volume for 1986.

Eighteen percent of the accounts reviewed by the GAO were either in error or lacked adequate documentation to support the amount billed. Errors were found in billings by all 16 lenders and, according to the report, ". . . generally resulted from lenders'

(1) miscalculating loan principal balances and interest subsidies due and (2) continuing to bill the Department after borrowers began repaying" (p.3). Four of these lenders had been previously reviewed by the Department and, according to the GAO, "none of the [Department's] site visit reports disclosed the kind of errors GAO identified" (p.4).

The U.S. Department of Education does not review lender compliance with collection due-diligence requirements, but requires guarantee agencies to review their top ten lenders at least every two years. Those represent 95 percent of total loan volume guaranteed by the Student Aid Commission for 120 lenders. Smaller lenders are subject to program reviews when major problems are suspected and on a random basis, as limited resources allow.

The Commission has established due-diligence requirements for lenders in California that are somewhat more stringent than federal requirements. Minimum standards specify lender contact with borrowers during school enrollment, immediately prior to graduation, during the six-month grace period after graduation before payments are due, and during periods of delinquency, before loans can be submitted for payment as defaults. As long as these steps are followed, lenders are immune from penalty if the loans are not repaid. Consequently, there is no incentive for lenders to exercise discretion in making the loans; the lender will receive full payment whether or not the borrower pays a dime.

Because lenders are ineligible for interest and special allowance subsidies once a loan is due, there is, in effect, a disincentive for lenders to delay in submitting default claims. Lenders also try to minimize the cost of collection efforts, since those are the primary costs that can affect their margin of profit. While a few major lenders are extremely responsible in their management of the loan program, most confine their activities, at best, to the minimum specifically required.

Since the lender decides who will receive a loan, makes the loan agreement with the borrower, and profits from the contract, assigning lenders some responsibility in controlling defaults would certainly be appropriate.

Proposed Alternatives for Increasing Lender Responsibility

1. Lenders should play a part in pre-loan counseling because prospective borrowers would likely take information about the cost of borrowing, repayment obligations, and the consequences of failing to repay more seriously from their lender than from the educational institution. Lender counseling would supplement pre-loan counseling performed at the college.

The Business of Student Loans

Student loans are big business, involving not only the banks, savings and loans, credit unions, pension funds and insurance companies which are the primary lenders, but a host of other investors and servicers who play a role once the loan has been made. A recent financial crisis reported in the Los Angeles Times *on February 2, 1989, involving $1 billion in loans held in trust by BankAmerica, reveals the magnitude and complexity of SL financing.*

The BankAmerica-held loans, originally made to students by various financial institutions, had been sold to the California Student Loan Finance Corporation (CSLFC), a private nonprofit secondary market, which sold tax-exempt bonds to finance the loan purchase. CSLFC entered into an agreement with BankAmerica to act as lender of record for the GSLs and as trustee to administer the bond issue. BankAmerica arranged for several other major banks, including Citicorp (the nation's largest) and two of Japan's largest banks, to provide letters of credit to protect bond holders against any possible loss.

An Encino company, United Education and Software (UES), was contracted by CSLFC and BankAmerica to service the student loans. UES was responsible for maintaining contact with borrowers, monitoring payments, and fulfilling legally mandated collection requirements with regard to delinquent borrowers. In August 1988, a program review conducted by a guarantee agency discovered that UES had submitted thousands of loans as default claims without having adequately serviced them. Some borrowers placed in default had reportedly never been contacted to begin repayment. As a result, the Student Aid Commission and the U.S. Department of Education have refused to honor guarantees on millions of dollars in defaulted loans. Negotiations are underway currently to try to arrive at a compromise settlement. In the meantime, BankAmerica has set aside a $96 million reserve to cover the expected cost of lawsuits threatened by the letter of credit banks. Sources quoted in the Los Angeles Times *indicate losses could exceed that amount.* ▪

2. Borrowers would also benefit from monthly or bimonthly contact with their lender, or the holder of their loan if different from the lender of origin. This would remind students regularly of their financial obligation, perhaps reminding them also of the importance of staying in school, and would give the lender more timely notice of student address changes or changes in enrollment status. This lender-borrower contact could be reinforced by school personnel, rather than leaving sole responsibility to the school for enforcing and monitoring a third-party obligation.

3. Lenders should also be held financially accountable for their default rates. If guarantees were paid at less than 100 percent when evidence showed that a lender was making insufficient effort to limit defaults, the lender would have an incentive to screen borrowers before offering a loan. Such a policy would likely have serious consequences for community college students, however, and could threaten the ability of the program to fulfill its intent, which is to provide a source of funds for students who have little or no credit history and who would not be likely to qualify for loans absent a government guarantee. To protect that function, it would be essential that borrower screening not be based solely on his or her credit rating.

   Any proposals that would increase a lender's administrative costs will meet with resistance from financial interests in the SL program. When multiple loan disbursements (by semester instead of by year) were first proposed during reauthorization of the Higher Education Act in 1986, lenders threatened to leave the program. Multiple disbursements has become a requirement and, to the staff's knowledge, no major lender has stopped making loans as a result. But, if SLs stop being profitable, lenders will stop making them available. Loans to community college and proprietary school students already carry less value on the secondary market than loans to students attending four-year colleges and universities, because of higher administrative costs. Any reduction in lender participation would affect community college and proprietary school students first.

Issue 2: *Should Educational Institutions be Held Accountable for the Default Rates of Their Students?*

The U.S. Department of Education has laid responsibility for solving the default problem squarely on the shoulders of the educational institution. Most colleges are willing to take some of that responsibility, as evidenced on the part of the community colleges by the efforts previously cited to limit borrowing. But, colleges argue that the responsibility should be shared: by the U.S. Department of Education, which sets program policy restricting the authority of colleges; by the California Student Aid Commission, which collects an insurance fee for its part in administering the program on behalf of the Department; and by lenders who make the loans and who, besides students, are the primary beneficiaries of the program.

Any educational institution that uses SLs as an enticement to recruit students into programs that are of poor quality or from which the student is unlikely to benefit should certainly be held responsible and penalized for abuse of the program. Schools that are guilty of such practices generally charge tuitions equal or close to the full amount of SL and other federal aid for which their students are eligible. Students turn all the financial aid they receive over to the school to pay the charges. When students become disenchanted and withdraw, the school retains the money and the student becomes a default statistic. Such practices at least border on fraud and appropriate action should be taken to halt them. But, it is a small number of proprietary institutions that are guilty of these abuses, and it would be irresponsible to hold all high-default-rate schools responsible for the reprehensible actions of a few.

Community colleges, which do not profit from SLs in any manner and which have voluntarily gone to great lengths to limit student borrowing, should not be held responsible for default rates they cannot control. The 17,000 community college students who received SLs last year are students who were offered loans by a lender, met all federal criteria for eligibility, were advised regarding any available loan alternatives and the obligations associated with borrowing money, were made to jump through hoops erected by financial aid offices to make sure a SL was not easy to obtain, and they could not be deterred from accepting the loan anyway. To penalize the colleges if those students default improperly blames them for structural problems in the loan program. Unless colleges are given the authority to determine who receives a loan, they should not be held responsible for defaults if they have done all that is within their authority to prevent them.

Issue 3: *Should Educational Institutions Be Given a Role in Deciding Who Can Borrow?*

Colleges have been in an untenable position since the beginning of the GSL program. All financial aid administrators have experienced instances when they were powerless to prevent someone from receiving a loan, even though they were certain, beyond all reasonable doubt, that the student would drop out of school and default. Sometimes this certainty is based on information about the student's past performance in school or with a prior loan; sometimes it is based on statements made by the student during pre-loan counseling. Regardless of the circumstances, school contact with the lender, the Student Aid Commission, and the U.S. Department of Education would all confirm that the student could not be denied the loan unless federal eligibility criteria were violated.

If educational institutions were given full authority to decide who should receive loans, however, denials would not be restricted just to those applicants judged as certain to default. SL borrowing among community college students would likely undergo another radical decline. Colleges would be reluctant to take risks in approving loans. Because the profile of a typical defaulter is much like the profile of a typical community college student, colleges would feel compelled to deny most applications, even though a minority of students fitting that profile actually default.

The central problem with the current SL program is the reliance on loans by low-income students in the absence of sufficient funding for alternative forms of financial aid. Giving decision-making authority to the colleges would not solve that problem, but would simply shift the responsibility for managing it to the colleges. Financial aid administrators would be put in the position of effectively denying the opportunity for postsecondary education to many students on the basis of their presumed credit-worthiness, rather than performing what is traditionally their role: helping to provide the economic tools to ensure access for all who demonstrate the ability to benefit from the programs offered.

Some sharing of the decision-making responsibility seems more appropriate. Those in the educational institution frequently have knowledge about a student that is necessary for an informed judgment regarding intent and ability to repay. Without benefit of the college's appraisal, lenders would not be in a position to fairly assess an applicant's potential. This shared responsibility could be accomplished in different ways.

Proposed Alternatives for Increasing the Colleges' Role in Loan Approval

1. One option would be to have colleges assign a risk-factor rating to each potential borrower after the student has gone through pre-loan counseling. Colleges would continue to certify loan applications based upon federal criteria, but their risk-factor rating would be reported to the lender on the school portion of the loan application. Responsibility would then rest with the lender to consider the risk factor in deciding whether to offer the loan.

2. An alternative approach would be to give colleges veto power over any loan, based upon some set of standard or institutionally developed criteria. Colleges would establish a loan review committee to make a disposition on each loan application, or to review decisions made by the financial aid office and hear student appeals. Criteria might include the following:

   - Does the student have a collegiate history that would indicate the likelihood of success or failure in his or her current educational program?

   - Are the student's goals and expectations reasonable?

   - Has the student had a previous loan default discharged through bankruptcy, or taken out of default only because of recent payments?

- Does the student have other options for financing his or her education? If not employed, are there good reasons why he or she cannot or should not work?

- Has the student demonstrated an understanding of the obligations that come with borrowing money?

This alternative would require statutory amendments.

3. Short of either of these structural changes in the loan-approval process, the U.S. Department of Education could authorize greater institutional discretion and flexibility in loan certification. For example, existing federal policy requires colleges to apply to SL borrowers the same satisfactory-academic-progress policies developed for all Title IV aid recipients. [This, in and of itself, is an improvement over policy in effect until 1987, which required standards for other aid programs but discouraged the application of any to GSL eligibility beyond those required for admission to the college.] Most colleges' satisfactory-progress standards permit students who fail once to meet the minimum standard to be placed on financial aid probation for one semester, during which they can continue to receive aid. This is important because many students who encounter academic trouble because of personal or family crises that are temporary in nature, are able to resume progress after a short time. Student problems are often related to their financial circumstances and to cut off all aid at the first sign of trouble would seal the coffin on the academic futures of many with potential. Some financial aid officers would choose, however, to deny SLs to students on financial aid probation because they are at greater risk for dropping out. This degree of flexibility should be allowed.

   Another area where some institutional discretion would be appropriate is in lending to students who are technically out of default, but who have defaulted in the past. Defaults can be discharged through bankruptcy. They can also be cleared through the guarantor if twelve consecutive payments are made. Some students who have pulled themselves out of default are now more mature, and it may be appropriate to allow them to borrow again. Others may have made their minimum payments only to establish eligibility for another loan. Through counseling, a student's reliability can often be discerned and colleges should have the authority to act on such information, instead of being required to certify another loan simply because a prior default has technically been cleared. [It is interesting to note that while such defaults are cleared for the borrower, they are never removed from the college's gross default rate. Once a default occurs, it is part of the college's record forever.]

   Finally, as pointed out in the report and recommendations of the Financial Aid Policy Task Force, the workload associated with the GSL program has grown exponentially, both with the changes in eligibility determination instituted as a result of statutory changes in 1986 and with the required and voluntary default-prevention activities added over the last five years. Neither the U.S. Department of Education nor the California Student Aid Commission provides any administrative funds for college operation of the program. The absence of resources has limited what colleges can do to prevent defaults and has strained the overburdened financial aid delivery system to its limits. Any proposal for additional responsibility on the part of educational institutions must be accompanied by administrative compensation to implement it.

Issue 4: *Are There Better Alternatives for Providing Aid to Some High-Risk Students?*

Educational opportunity regardless of economic origin has been a commitment by the nation and the State since creation of the federal Basic Educational Opportunity Grant (now known as the Pell Grant) and the California Opportunity Grant (Cal Grant B) programs. Those two programs and supplemental programs like the Supplemental Educational Opportunity Grant (SEOG), College Work-Study, and Extended Opportunity Programs and Services (EOPS) have enabled hundreds of thousands of low-income persons to transform their lives and become productive, contributing, and even leading members of our society. The history of student financial aid is one in which all educators and all caring citizens can take pride.

In California, the community colleges are a monument to educational opportunity. The State has opened the door to all who have the initiative and can benefit from postsecondary education and has offered low-cost programs to meet the varied needs of different individuals and different communities since the turn of the century. California has the highest rate of college-going participation in the country and society has benefited from a better-educated populace.

While only about 10 percent of community college students receive some form of financial assistance, the percentage of full-time students on aid is significantly higher. The receipt of financial aid enables students to attend full time who would otherwise have to work more hours and attend school less. A greater percentage of aid recipients have grade-point-averages above 3.1 than non-aid recipients, and a larger percentage have transfer as a goal.

The turn to loans to finance students' education is a recent phenomenon and it has had a cost far beyond that of defaults. Leading educators, among them Secretary of Education Lauro Cavazos, have pointed to the reliance on loans as an obstacle to increasing minority enrollments in our colleges and universities. The mounting debt burden under which many college graduates are starting their professional lives is of growing concern across the nation.

One Student's Loan Experience

Take, as a hypothetical example, a 22-year-old woman who is working in a clerical job, earning $5.00 an hour, and wants to become a teacher. She is a high school graduate, but she was married at the age of 18, and had one child and another on the way when her husband left her at age 19. She receives no child support and 38 percent of her gross income goes to child care, but she has managed to keep her children fed and clothed on her salary. She goes to City College and enrolls for 12 units of evening classes. Through assessment she learns that she can enroll in English 1A, but her math skills are weak and she needs at least one semester of remediation.

This student makes it through her first semester with a 2.75 grade point average, but she is doubtful of her ability to continue. Her mother watches the children one night a week, but she has to hire a babysitter on Mondays and Wednesdays (her campus child development center is only open during the day and has a six-month waiting list). She managed to find two of her text books at a used bookstore near campus, but the other two were purchased at the college bookstore and altogether they cost her $125. She was barely making ends meet before, and these extra expenses have just about put her over the edge financially.

She has always been a conscientious employee and her supervisor likes her, but lately she has been making some mistakes. She has to study after the children have gone to bed and after the housework and preparations for the next day are finished, and she is so tired at work that it's hard to always concentrate on what she's doing. She was late for work twice last month.

Her supervisor finally asks her what the problem is and when our student explains her situation, the supervisor suggests she make some changes. The company would be willing to reduce her working hours to 30 per week and she might qualify for financial aid to make up for the lost income. She is excited about that prospect and goes to the financial aid office to apply for aid.

She is astounded by the financial aid application she has been given to fill out, but she completes it the best she can. She mails it off as instructed and waits anxiously for a reply. In the meantime, the spring semester has started and she is barely hanging on with all of her financial and other responsibilities, but she is hopeful that relief is n the way. When she finally receives her report from the financial aid application processor, she finds it hard to understand but thinks it shows that she is eligible for almost as much aid as she had hoped for.

(continued)

She goes back to the financial aid office to get her grants and, two weeks later when she has brought back all of the supplemental paperwork that they have asked her for, she is scheduled for an appointment with a financial aid advisor. The advisor explains that she will receive a Pell Grant that will cover about one-third of her financial need. Although she would be eligible for other programs, the college ran out of funding for campus-based aid more than a month before the semester began. The remainder of her need can't be met unless she wants to apply for a SL. The responsibilities of borrowing are explained to her and she is sent away to think about what she wants to do.

She is reluctant to go into debt, but she sees no other way to stay in school. She has seen an ad by a local bank in the school paper, promising a check within a week of receiving her application. As she looks at the stack of unpaid bills on her table, that prospect is very appealing. She applies for the loan and is optimistic, once again, about getting through school.

This student will take three years plus one semester to get her AA degree and meet all of the lower division requirements for transfer to CSU. By the time she leaves City College, she will owe almost $8,000 plus interest. If all goes according to plan, it will take her another two and one-half years to earn her BA and her teaching credential. She will graduate in January, with a total debt of more than $15,000. The grace period on her loans will expire in July and her first monthly payment will be due in September. Given the current teacher shortage, she will probably have a job by then. The average starting salary for elementary and secondary school teachers in California is $21,842. Her monthly loan payments of approximately $190 will take 15 percent of her take-home pay and she will owe payments for ten years. Her older son will graduate from high school the same year she pays off her loan.

It takes a high degree of motivation and maturity for many students who come into the community colleges to surmount the multiple obstacles on their course to completing their education. In a discussion of student loan defaults, there is a logical focus on the three in ten student borrowers who fail, and a tendency to disregard the seven in ten who succeed. The prospect of ten years of substantial debt after college is one more barrier for disadvantaged students to overcome. It serves to discourage students from persisting when other difficulties confront them, and it places a severe hardship on those who succeed.

For many students, work-study is a much more effective and appropriate form of assistance than loans. Through work-study, students pay their way as they go, instead of accruing a debt to be paid upon graduation. When students are fortunate enough to find work-study jobs in areas related to their course of study, their experience can actually further their education and can put them in a better position to obtain employment when they leave school. Even when placements are not directly related to career goals, working in a supportive, challenging setting can contribute to a student's development. Research has shown a positive correlation between student persistence and the receipt of work-study and grant aid, but no such relationship with loans.

The funds allocated to most colleges for the federal College Work-Study program fall far short of the need. A few colleges, on the other hand, have had to return part of their allocations in recent years because of barriers to their effective utilization. These problems need to be corrected to make work-study a more useful alternative.

Proposed Alternatives to Increase the Effectiveness of Work-Study Programs in Preventing Defaults

1. Colleges should be given the authority to deny loans to students who have the ability to work, when work-study funding is available to meet their financial need. Students who are aware that colleges cannot refuse them a SL have been known to simply decline a work-study award and insist on receiving the loan. Colleges need the ability to assess each student's situation and determine whether work or a loan is the appropriate way to serve the student's and the institution's interests.

   Several categories of students either cannot or should not work while they are in school. For example:

   - Single parents who do not have access to reasonable child care services.

   - Some students with disabilities who will not have employable skills until their educational programs are completed.

- Students in nursing programs and some other technical programs that require extensive practicums.

- Some full-time students who require extensive tutoring and support to maintain academic progress.

- Some limited-English-speaking students and some students with serious basic skill deficiencies who are not readily employable until their language or other basic skills are improved through study.

The authority for a college to substitute work-study for loans would have to be applied selectively to provide for these circumstances.

2. Some colleges do not have sufficient resources to pay the institutional matching portion of College Work-Study wages. This problem is about to worsen because the matching requirement, which has been 20 percent, will increase to 25 percent for 1989-90 and to 30 percent for 1990-91 and beyond. The institutional matching requirement should be eliminated for on-campus placements in nonprofit institutions.

3. The wages paid to work-study students are often lower than students can earn working off campus. Additional funding should be sought to enable community colleges to pay competitive wages.

4. Limited or non-existent college job-placement and job-development programs are another serious impediment to making full use of work-study as an alternative form of aid. Funding should be sought to enable districts to strengthen these programs. Without a viable job-placement program, students who have been given work-study awards are often left to their own devices to find employment. Some succeed; others do not. Financial aid offices have to over-award their work-study funds to compensate for students who fail to find jobs. Other students who have the eligibility and desire to work more hours are then denied that opportunity.

   Job-development is a necessary function to provide students with career-related employment. The College Work-Study program has always permitted some student placements in off-campus nonprofit agencies, and current law also allows limited placements in private, for-profit enterprises, provided that jobs are academically related. In many communities, the potential exists for large numbers of off-campus placements, but the administrative costs to put such a program in place are high. Colleges and districts should be encouraged to participate in community- or employer-based consortia to explore job placement opportunities for work-study students.

5. The federal College Work-Study program permits colleges to expend up to 10 percent of their work-study allocations to establish Job Location and

Development (JLD) programs. Only a small number of community colleges take advantage of this option. Most do not, because the shortage of funds for work-study placements greatly exceeds the shortage of jobs. In the past, JLD funds could only be used to develop off-campus placements with nonprofit agencies. Current law provides for some restricted on-campus job-development activities. Colleges, particularly those with unexpended College Work-Study funds, should be encouraged to reevaluate their participation in this program, based on the changes in law.

6. Many financial aid applicants are already working when they begin school. Unless the college can offer better-paying or more educationally rewarding jobs, work-study will not help these students. If a policy were established that guaranteed grant aid instead of loans for working students on financial aid, it would serve as an incentive for students to continue working, lessening the potential burden on public assistance and financial aid resources.

APPENDIX

Task Force Recommendations

The Financial Aid Policy Task Force urges the Chancellor to seek a commitment from the Board of Governors to assume a strong leadership role on behalf of the community colleges for a policy to effectively resolve the GSL default problem. To that end, the Task Force offers the following short- and long-term, general and specific recommendations.

To make an immediate impact on rising GSL default rates and to respond to the proposals of the U.S. Department of Education, the Task Force recommends that the Board of Governors:

1. *Encourage districts to begin immediately to implement the provisions of SB 2555 for withholding school services to students who are in default. Further, colleges should be encouraged to publicize such action broadly, both on and off campus.*

2. *Encourage districts to provide training in basic loan administration, with emphasis on deferral procedures and default prevention, for all college personnel who interact with students in an advisory capacity, such as counselors, Transfer Center personnel, and instructors.*

3. *Encourage districts to prevent technical defaults through enhanced loan counseling and student follow up, to be provided by identifying resources to supplement current financial aid staffing.*

4. *Direct the Chancellor to prepare a response on behalf of the Board to the U.S. Secretary of Education regarding the proposed rules on GSL administration. The response should emphasize the following:*

    - *The Board of Governors shares the Secretary's deep concern about GSL default rates and is taking action to correct the situation in California's community colleges to the limit of its authority.*

    - *The Secretary's proposal to take LS&T action against schools solely on the basis of their default rates fails to recognize factors beyond institutional control that give rise to student defaults.*

    - *The Secretary's proposal to terminate institutional eligibility to participate in all Title IV financial aid programs inappropriately associates GSL defaults with the administrative capabilities of financial aid offices. The proposal is punitive rather than corrective and is unacceptable given the nation's commitment to equal educational opportunity.*

- *Standards for program reviews triggered by institutional default rates should include criteria that recognize institutional efforts to reduce defaults, characteristics of the student body, and the economic and employment conditions within an institution's service area.*

- *Requirements for providing consumer information and for analyzing the causes of default should be deleted, recognizing that the primary causes of default are not institutional.*

- *Appropriate responsibility for preventing defaults should be placed on the lender.*

As a long-term strategy for reducing student dependence on loans, and thereby limiting GSL defaults, the Task Force recommends that the Board of Governors:

5. *Continue its efforts to provide students from diverse backgrounds with the means to define their goals in attending community colleges and to achieve success in meeting those goals by:*

    - *Reaffirming the "open door" admissions policy for all California residents who can demonstrate the ability to benefit from a college education.*

      Recognizing that the vast majority of students who borrow to attend college do benefit from the education they receive, do repay their student loans, and do repay society for the opportunity they have been afforded, the Financial Aid Policy Task Force urges the Board of Governors to reaffirm its commitment to equal educational opportunity and to seek a solution to the problem of GSL defaults within that context.

      The Belmont Task Force was convened by Congressman Pat Williams, Chair of the House Subcommittee on Postsecondary Education, to study the GSL default problem. With a membership representing lenders, guarantee agencies, students, postsecondary institutions financial aid officers, secondary loan markets, congressional staff, and the U.S. Department of Education, the task force cautioned in its Final Report in February 1988 that although denying loans for first-year students would accomplish a significant reduction in the default rate, without alternative forms of aid, "such an approach would effectively end the national policy of not having income as a barrier to attending college."

    - *Continuing efforts to secure full funding for matriculation services to improve student retention.*

      To the extent that students can be helped to succeed in their educational endeavors through quality orientation, assessment, advisement, counseling, placement, and follow-up services, loan defaults can be prevented.

- *Encouraging districts to evaluate the impact of matriculation on financial aid recipients as a component of local matriculation-evaluation plans.*

  There is evidence that suggests a positive correlation between student retention and financial assistance in the form of grants and work study that does not hold true for loans. Whether matriculation services can have a positive effect on the retention of student borrowers is a question that deserves further consideration.

- *To the extent that other resources are available to meet students' financial need, encouraging financial aid administrators to adopt packaging policies that limit GSLs for first-year students.*

  The Chancellor's Office policy that permits the substitution of an EOPS grant for a GSL in a student's financial aid package is an example of pro-active default prevention. Other such approaches should be identified through consultation with financial aid professionals and publicized to encourage broader implementation.

6. *Seek and support initiatives that would increase federal funding for grant and work study aid as an alternative to loans for low-income students by:*

- *Supporting federal initiatives to make the Pell Grant an entitlement program.*

  Pell Grant funding currently relies on annual appropriations that have never fully covered program costs called for in statutory provisions. As a result of annual shortfalls in funding, scheduled increases in the maximum amount of the Pell Grant have been delayed in past years, and a linear reduction in funding for 1985-86 eliminated some otherwise eligible students. It is ironic that the GSL is an entitlement program and the Pell Grant, designated for the neediest of students, is not.

- *Seeking Congressional action to increase the proportion of educational costs covered by the Pell Grant.*

  The funding formula for this program currently provides for grant amounts that theoretically cover 60 percent of a student's educational costs. That amount is determined by a formula that restricts costs artificially, and maximum grant amounts for community college students actually represent a much smaller percent of real educational costs - approximately 16 percent, according to the Student Aid Commission. A substantial increase in Pell Grant funding would lessen reliance on loans to fill the gap between grants and the actual cost of attendance.

- *Supporting annual budget initiatives to increase funding for the campus-based Supplemental Educational Opportunity Grant (SEOG) and College Work Study programs.*

  Funding for these federal programs has not increased significantly since the current Administration took office. Cost savings in these programs are more than offset by increased GSL costs in subsequent years.

7. *Seek and support initiatives at the state level that would increase financial aid funds for low-income community college students as an alternative to loans by:*

   - *Supporting legislative and budgetary initiatives to increase the share of Cal Grant funds provided to community college students.*

     The Student Aid Commission is requesting funds in its 1989-90 budget for 1,500 new Cal Grant Bs, 51 percent of which would, by statute, go to community college students. The Board should support this budget proposal. It should be recognized, however, that substantially greater levels of grant funding are required to have any impact on the problem of unmet student financial need.

     The Cal Grant A, B, and C programs provided $132 million in financial aid to California students in 1987-88. Of that amount, only 9.8 percent ($12.9 million) was awarded to community college students. In contrast, 49 percent ($64.7 million) went to students attending four-year independent colleges and universities.

     The average grant at four-year independent institutions is four times the average at community colleges because of differences in the cost of tuition and fees. Although one purpose of the Cal Grant programs is to allow students choice among postsecondary institutions, another purpose is to provide access for the large and growing number of low-income, disadvantaged students who, by and large, attend community colleges. Protecting choice among high-cost institutions should not mean that less than 10 percent of funding is dedicated to access. Some changes in the structure of the Cal Grant programs would be needed, in addition to an increase in Cal Grant funds to make more aid available to community college students, particularly independent students, who tend to default in greater numbers.

     As an alternative to expanding or redistributing Cal Grant funds, the Board might seek legislation to establish a new grant program for low-income community college students. With unmet financial need for this group estimated at $400 million, a substantial investment of state resources could be justified. Such legislation would raise additional policy considerations, however, such as who would administer the program, how many grants to fund for what amount, and how to target awards to have the greatest impact on reducing loan defaults. Limiting new grant aid to first-year students might help students defer borrowing until their second year in college, when the likelihood of their completing an educational program is increased. In discussing these issues with representatives of the other public segments of higher education, Chancellor's Office staff found that they are also concerned with the problem of first-year defaults and that the degree of support for an exclusively community college program is questionable. Staff of the Student Aid Commission have expressed a preference for working within the Cal Grant B program to increase financial aid to community college students.

- *Supporting budget initiatives to expand the State Work-Study Program.*

  This program was launched on a pilot basis in 1987-88 at 15 colleges, including 3 community colleges. It is designed to provide part-time work off campus and in the private sector, as well as on-campus employment. With no funding provided for expansion this year, it remains a pilot program. If adequately funded, including sufficient funding for job-development activities, the program could provide another alternative to loans for some students.

8. *Encourage community college districts to provide adequate administrative support for the operation of financial aid offices and assist them to obtain funds for that purpose by:*

- *Urging the California Student Aid Commission to again seek funding to provide an administrative cost allowance for schools participating in the GSL program and offering full Board support throughout the State Budget process.*

  The Student Aid Commission has acknowledged the workload implications of its Default Prevention Plan. To the extent that the time and energies of campus financial aid staff have been diverted to default-prevention activities, the delivery of other aid programs has suffered. An apparent decline in the number of Pell Grant recipients in 1987-88 may be attributable in part to the new GSL-related workload. This situation cannot be allowed to continue.

- *Seeking action to have the U.S. Department of Education establish an administrative cost allowance for the GSL program.*

Small administrative allowances are provided to colleges that administer the Pell Grant and campus-based federal aid programs. Although these allowances represent less than 10 percent of the total administrative funding for financial aid offices, their contribution to district operations is essential. Since 1986, the federally mandated workload for GSL processing has increased dramatically and the associated costs should be compensated.

- *Encouraging districts to consider allocating a portion of their program-improvement funds to financial aid administration, particularly at colleges with high default rates.*

  With adequate staffing, some actions could be taken to have an immediate impact on a college's default rate, particularly in avoiding procedural defaults.

- *Affirming the charge of the Financial Aid Policy Task Force to examine the issues of financial aid workload, resources, and unmet financial need.*

  Beyond obtaining increased non-loan funding as an alternative to the GSL, financial aid offices must have the administrative capacity to deliver those funds to students. A full examination of barriers to delivery is warranted.