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ABSTRACT

This paper offers proposals for streamlining and simplifying the federal student loan programs in light of legislative and budgetary changes in progress during the early part of the Clinton Administration. The recommendations are based on 35 proposals submitted by institutions, associations, guaranty agencies, secondary markets, lenders, and loan servicing organizations. Student and institutional imperatives were developed and for each of those organizational categories and participant, program features, and delivery issues are identified. The common themes between the student and institutional imperatives led to the following program-wide imperatives for an efficient loan program: (1) there should be one student loan program (with a single set of terms and conditions) from which a majority of undergraduates receive funding; (2) all loans should be guaranteed and held by one entity and all of an institution's student loans should be guaranteed and serviced through one guarantor and lender; (3) all borrowers should be offered the option of refinancing existing loans to obtain a single variable interest rate; (4) merged deferment terms, and income-contingent/Internal Revenue Service repayment options must be made available at the request of the borrower; (5) the loan program must be fully integrated into the existing Title IV delivery system using a single application instrument; and (6) a Title IV data base with sufficient monitoring and delivery capability must be developed. (JB)

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STUDENT LOAN PROGRAM SIMPLIFICATION

SYMPOSIUM

BRIEFING DOCUMENT

Advisory Committee

On

Student Financial Assistance

HE026443

April 1993

INTRODUCTION

In the Higher Education Amendments of 1992, Congress directed the Advisory Committee on Student Financial Assistance to conduct a study of the Federal Family Education Loan Program. Specifically, the Committee was charged with an examination of:

- the paperwork burden experienced by financial aid officers within the current structure of the loan program;
- simplification and standardization of forms, procedures, and all other aspects of guaranty operations for the purpose of data exchanges with the Department of Education, its proposed National Student Loan Data Base, and other agencies;
- simplification of the bank repayment process to minimize borrower confusion; and
- efficient utilization of loan programs to minimize multiple program borrowing in postsecondary education.

The Committee developed a study plan in August 1992 that encompassed a number of activities intended to address these specific issues while facilitating community involvement. Three hearings were scheduled and conducted during the fall of 1992 as the "discovery phase" of the study began. The Committee invited students, financial aid administrators, association representatives, along with guarantors, lenders, servicers, and secondary market spokespersons to identify sources of complexity in the existing loan process. As a result of the information presented at the hearings, six primary sources of complexity were identified by the Committee.

- Multiple, overlapping loan programs exist, none of which have sufficient annual limits to discourage multiple program borrowing.
- Terms and conditions conflict among the loan programs.
- The programs operate under burdensome legislative and regulatory requirements, most of which have been created to control program costs and default rates.
- Lender and guarantor policies are inconsistent.
- Loan processes and forms are not standard.

- The existing data and network infrastructure is insufficient.

A new direction was introduced on March 3, 1993, when Senator Claiborne Pell wrote to Committee Chairperson Lynn Burns requesting a change in the focus of the study. Specifically, Senator Pell requested that, in light of renewed interest in Congress and the White House about a direct loan program, the Committee compare a simplified student loan program with a direct lending program. He also requested that the Committee give:

> serious consideration to the feasibility of simplifying the manner in which both the current loan program and a direct loan program might be delivered. Because of changes made in the Pell Grant delivery system, I am especially interested in knowing if you believe either the current program or a direct loan program, or both, might use the Pell Grant system, as well as how it might be modified to accommodate use as a delivery mechanism for student loans. Is it, for example, possible to have one federal form, one processor, and one data base for all Title IV student aid programs?

In order for the existing program to be able to compete with the delivery component of direct lending, radical changes would need to be implemented. Minor "tinkering" would not allow the Committee to reach the goal stated by Senator Pell.

The passage of President Clinton's budget package in the House of Representatives on March 18, 1993, and its subsequent passage by the Senate, has created considerable uncertainty about the future of the existing program structure. The budget legislation would seem to mandate the implementation of a full-scale direct lending program by 1997 in order to achieve savings to be used to fund a national service program requested by the President. Opponents of the President's budget reduction plan suggested a number of proposals intended to save federal dollars that would have maintained the lender-based student loan program while significantly altering the current structure: administrative cost allowance to guaranty agencies would have been eliminated, reinsurance payments to lenders and guarantors would have been reduced, reinsurance fees would have been increased, and special allowance rates would have been reduced. These actions would have significantly reduced the number of guarantors, lenders, and secondary markets participating in the program. However, according to the Congressional Budget Office, such proposals were unable to match the $6.0 billion savings over five years anticipated with a switch to direct lending.

In the face of these events, the Committee has chosen to take a broad approach which encompasses both alternatives. Certain imperatives must be addressed if the Federal Family Education Loan Program is to continue with private sources of funding. Similarly, if Congress is to avoid creating a costly, complex direct lending program, it must not repeat the mistakes of the past.

Regardless of the design chosen, six program-wide imperatives are evident from the testimony and proposals received as intrinsic to the efficient, streamlined processing desired by students and institutional representatives.

- The number of participants must be minimized.
- There must be a single student loan program.
- Single source borrowing must be mandated.
- Repayment options must be expanded, including refinancing of existing notes.
- Loan application and processing should be fully integrated into the Title IV system.
- A more complete Title IV recipient data base must be developed.

In February 1993, the Committee sent a solicitation to over 350 institutions, associations, guaranty agencies, secondary markets, lenders, and loan servicing organizations asking for their recommendations of strategies to address sources of complexity. The community submitted thirty-five proposals. The process of analyzing the responses then began with the goal of identifying the most promising recommendations for program reform.

The Committee derived from proposals student and institutional imperatives for a streamlined student loan program. Submitted proposals related to three specific aspects of the programs: participants (the number and type of entities with which a student or institution must interact); features (fundamental program design, terms and conditions, or repayment); and delivery (the application, processing, disbursement, or repayment of funds process).

STUDENT IMPERATIVES

Students must be able to obtain from and have their loans serviced by one entity, secure loan funds from a single program which has one interest rate and set of deferment terms and flexible repayment terms, and apply for loans using the FAFSA.

Primary student imperatives are summarized in exhibit A on page 5.

Program Participants

Fundamental to attaining the goal of simplification for student borrowers is the concept of single source borrowing for all of a student's loans, resulting in only one entity to repay. Recommendations from students, financial aid administrators, and a number of guaranty agencies stress the importance of implementing this concept if this program is to be simplified. All of a student's loans must be housed in one location, resulting in administrative consolidation of payments without being forced to undertake the time-consuming, expensive process of formal consolidation. The student would update only one entity with demographic changes, enrollment updates, or deferment confirmation in order to have information posted to all of his or her loan accounts.

Most respondents indicated that this would reduce the risk of avoidable, technical default due to the failure of information to be communicated to all holders of a student's loans. This would also significantly reduce paperwork requirements for the student, since they would complete one document to affect any desired information update. The student could contact a single agency or institution to obtain the most current information on their loans. In addition, students strongly recommended that the information be available through a single toll-free number, citing examples of the current difficulty they experience in trying to obtain status or balance information.

EXHIBIT A
FEDERAL FAMILY EDUCATION LOANS
STUDENT IMPERATIVES

PROGRAM PARTICIPANTS

- Single source borrowing
  - One guarantor/one lender/one servicer/one secondary market for all the student loans of a borrower and one entity to repay
  - One source for all information on student loans of a given borrower (preferably toll-free number)
  - One entity to update information on all loans

PROGRAM FEATURES

<u>Components</u>

- One loan program (with subsidized and unsubsidized components)
- Easy to understand process and terms
- Standard, minimal (or no) origination and guarantee fees

<u>Interest Rates</u>

- Variable interest rate on all loans (past and new)

<u>Repayment</u>

- One set of deferment/forbearance rules and documentation requirements
- Responsive servicing (quick error correction, rapid posting of changes, deferments, etc.)
- Simplified loan repayment options (direct withdrawal from checking/savings accounts, IRS collection available at borrower's option)
- Availability of income-contingent repayment
- Reasonable, sufficient time to repay loans based on total borrowed without needing to go through formal consolidation
- Simple, free consolidation available at current variable rate

PROGRAM DELIVERY

- One application (tied to FAFSA)
- Standard policies regarding loan minimums, application process
- Loan funds available when student fees are due
- Simplified reapplication process

Numerous respondents indicated the need for only one loan program, not the mix of subsidized Stafford, unsubsidized Stafford, PLUS, SLS, and Perkins Loans currently operating. In a streamlined system, there needs to be one program with subsidized and unsubsidized components. Parents and students would be able to able to borrow the unsubsidized funds. Loan limits of the separate programs would be merged into one loan maximum; therefore, the overall indebtedness level would not increase from current levels. Students would no longer need to obtain funds from multiple programs, simplifying not only the obtaining of loans, but also the repayment of borrowed funds. A single program would also result in a greatly simplified application process and a single set of terms and conditions to govern the program, effectively eliminating most of the conflict experienced in the current system.

Students also strongly supported the reduction or elimination of origination and guaranty fees. Several respondents pointed out that the fees were never adequately explained to the borrower and seemed unwarranted. If there is any "processing fee" for student loans, it must be minimal and standard for all such loans.

The action taken by Congress to establish a competitive variable interest rate was met with positive reaction by most respondents; however, many indicated that students should be able to refinance existing loans to obtain that same variable rate. Students with even small balances on an existing Stafford or SLS loan are prohibited from obtaining new loans at the more advantageous rate. Allowing all loans to be refinanced at a single, variable rate would again ease administrative consolidation, simplifying the repayment process for the borrower, and addressing part of the problem of conflicting terms and conditions.

A streamlined program must provide the student with a single set of deferment rules and documentation requirements. In the past, these status categories have been governed by borrower loan history, i.e. the rules in effect at the time the student first obtained a student loan. Rules have changed over the years and categories have varied widely. Most respondents indicated that a streamlined set of deferments or forbearance conditions in terms easy to understand for the borrower should apply for all loans, old and new. To accomplish this, students must be permitted to refinance their existing loans, the terms changed to reflect the new deferment structure.

Students also require a more responsive servicing system than currently exists. A simplified system needs to effect rapid error correction and posting of information updates, neither of which are present in current loan servicing.

Repayment options must be expanded in any new system to provide borrowers a simpler way to repay funds. IRS collection or direct withdrawal from a student's checking or savings account must be made available to all borrowers. Borrowers should be able to easily obtain an income-contingent repayment schedule, and should be permitted a reasonable, sufficient time to repay loans without being forced to apply for a formal consolidation loan. The repayment system needs to be restructured in order to reduce defaults and create a more consumer-orientation.

The existing Consolidation Loan program must also be made less complex and costly for borrowers. Holders must be required to consolidate loans *at the borrower's request.* Currently, students reported experiencing difficulty because certain holders refused to participate in the consolidation process. In addition, the program must have an interest rate that is more fair to the borrower, whether that be the exiting variable rate or the actual weighted average of all loans being consolidated. The cost of consolidating must also be reduced or eliminated.

Program Delivery

Loan application and delivery must be integrated fully with other Title IV application and delivery. Several respondents suggested tying the loan application process with the Free Application for Federal Student Aid (FAFSA) process, so that the student is required to complete only one document to be considered for all Title IV aid. This would eliminate one of the issues surrounding non-standard forms, since the application would be the same regardless of what entity provided the loan funds.

In addition, students need a standard process and policies to follow to obtain a student loan. There should be a processing paradigm that holds true for all student loans with established loan minimums and processing requirements, thus simplifying processing and counseling.

Delivery of funds must be expedited as part of this process. Respondents indicated the need for loan funds to be available for students when educational fees are due. Therefore, the system must be significantly streamlined and its information made available to all necessary parties more rapidly.

Finally, respondents strongly recommended that a standard reapplication process (such as that mandated for other Title IV programs in reauthorization) be established. Students should be required to report only information that has changed from their prior year's application. This would significantly expedite the process for students and be another way to reduce the redundancy of information the student is forced to report on a yearly basis.

INSTITUTIONAL IMPERATIVES

Institutions also require single source borrowing, a single loan program with one interest rate and set of deferments to administer, a standard application form and process, and performance-based regulatory requirements. Institutional imperatives are summarized in exhibit B on page 10.

Program Participants

Single source borrowing would eliminate many of the complications in institutional processing of loans. Institutional representatives recommended that they interact with only a minimal number of lenders, guarantors, and servicers in an attempt to eliminate the problem of differing policies between lenders and guaranty agencies. This would also force the simplification of communication, since the institution would then communicate with only a few entities instead of hundreds as they do currently. In addition, respondents indicated that policies for all participating guarantors, lenders, and servicers should be standard. Furthermore, there needs to be only one set of reports and a streamlined set of reporting requirements acceptable for the purposes of exchanging information among participants. With a limited number of participants, institutions would be able to inform one lender, servicer, or guarantor to update the records of all its students.

Program Features

There must be one loan program with one set of terms and conditions if institutional loan processing is to be simplified. Institutional respondents strongly recommended the consolidation of all loan programs into a single source of funds, emphasizing that the new program should be easy to process and explain. In this new structure, institutional representatives expressed the need for greater control of the process and availability of funds. Once a loan has been approved, funds should be able to be expeditious delivered to the students in order to meet educational expenses on a timely basis. Numerous respondents also indicated that the program must operate under more performance-based regulations. For example, if an institution does not have a documented problem with student retention during the first four weeks of enrollment, it should be exempted from rules requiring delayed disbursement of funds.

Institutional respondents also recommended that a simplified program have only one interest rate for all borrowers. As a result of the existence of conflicting terms and conditions, adequate student advisement is a nearly impossible task, requiring that the financial aid counselor explain the numerous combinations of interest rates possible based on the students' loan histories.

While repayment issues have a much more significant impact on students, respondents indicated the need for one set of deferment and forbearance rules and documentation requirements to govern all borrowers. This will simplify counseling and deferment form processing for all institutions.

EXHIBIT B
FAMILY EDUCATION LOAN PROGRAM
INSTITUTIONAL IMPERATIVES

PROGRAM PARTICIPANTS

- Single source borrowing
  - One lender/one guarantor/one servicer with which to interact
  - Standard policies for all participant guarantors/lenders/servicers
  - One standard set of reports/reporting requirements
  - One source to update all information/correct errors

PROGRAM FEATURES

Components
- One loan program
- Easily described process and terms
- Greater control over availability of funds
- Performance-based regulations

Interest Rates
- One standard interest rate

Repayment
- One set of deferment/forbearance rules and documentation requirements

PROGRAM DELIVERY

- One application
- One standard loan application process
- Integrated financial aid awarding process
- Simple receipt and disbursement of funds process
- Funds available through EFT
- Electronic communication capability for information inquiry and updates
- Standard data record format for all electronic exchanges

Program Delivery

One application, preferably one which is integrated into the existing FAFSA, allowing a single form to suffice for awarding all federal financial aid must be mandated. The Department of Education and the student loan community have experienced apparently unresolvable differences in the development of a single loan application. This problem would be eliminated if necessary questions and certifications were added to the FAFSA. Respondents indicated a strong interest in streamlining the application and application process. The multitude of forms have simply overwhelmed the existing system, resulting in processing errors, and delayed delivery of funds to students due to unintentional errors in certification. The varying processes required by the guarantors and lenders has forced institutions to maintain parallel processing systems, a scenario that could be eliminated if a single process was specified.

Several institutional proposals suggest that there be an integration of the loan programs into the Title IV financial aid application process. A number of respondents indicate that in the new system the FAFSA should serve as the application document for loan funds as well as other aid. The FAFSA should contain all certifications for Title IV aid, reducing the burden on institutions.

The process of delivering the funds to the borrowers also received much attention from those who submitted proposals. Documentation requirements must be streamlined, including the elimination of the Borrower Authorization Statement, if the process is to be simplified and made more efficient.

The respondents also recommended that the entire process must have more electronic exchange capability than currently exists. Student data should be available and able to be updated at a central source via electronic means. Whatever electronic exchange process is designed, a standard data format should be required for all participants in order to avoid the need for parallel processing systems on the part of the institutions, in addition to providing information which would result in the Student Status Confirmation Report (SSCR) no longer being necessary.

PROGRAM-WIDE IMPERATIVES

The common themes between the student and institutional imperatives led to the Committee's recommendation of six program-wide imperatives for an efficient loan program.

- *There must be one student loan program (with a single set of terms and conditions) from which a majority of undergraduates can receive funding.* The Committee agrees with the respondents who suggested that Subsidized Stafford, Unsubsidized Stafford, SLS, PLUS, and Perkins be merged into a single program. The unified program's loan limit should reflect a merging of the existing programs' limits, not an increase or decrease in overall loan limits. All new loans must be issued with the revised variable interest rate and terms and conditions.
- *All of a borrower's loans must be guaranteed and held by one entity, implementing single source borrowing. Similarly, when possible, all of an institution's student loans should be guaranteed and serviced through one guarantor and lender.* This is the only way loan processing, repayment and communication between participants can be improved and streamlined.
- *All borrowers must be offered the option of refinancing existing loans to obtain a single variable interest rate and merged deferment terms.* This would assist in administrative consolidation, thus significantly decreasing administrative burden for all participants. Furthermore, it would substantially decrease federal expenditures for the in-school subsidy, currently the most expensive component of the Federal Family Education Loan Program.
- *Income-contingent/IRS repayment options must be made available at the request of the borrower.* Income-contingent repayment, as piloted by the Department of Education created an extremely complicated, time-consuming process for the borrower. The problems encountered could be corrected by incorporating an IRS-collection component.

- *The loan program must be fully integrated into the existing Title IV delivery system, utilizing the FAFSA as the application instrument.* Experience has shown that any program relying on a separate delivery system will lead to multiple forms, processes, and regulations. We have in the Pell Grant delivery system an effective method of fund disbursement which currently delivers almost $6.5 billion to 4.3 million students. Incorporating the loan delivery system with Pell delivery would minimize institutional confusion and burden. This would also address the issue of administrative capability, since no new delivery system would be required.
- *Similarly, a Title IV data base with sufficient monitoring and delivery capability must be implemented.* The need for the historical National Student Loan Data Base (NSLDB) will be minimized if all new loans are issued at the variable interest rate regardless of borrower loan history. Further development of a separate data base should be curtailed and effort should be directed at creating a more centralized Title IV data system which interfaces with the first phase of the NSLDB where necessary.

Implications for the Current Program

After consideration of the testimony and proposals submitted, the Committee has no doubt that major changes must be made in the existing program if the burden on student and institutions is ever to be lessened. As Congress and the Department mandate program reform, specific imperatives (summarized on page 15) should be considered.

Little doubt remains that the sheer number of participants has increased costs and complexity. With thousands of lenders, over 40 guaranty agencies, and numerous secondary markets, the first step is clear--there must be a radical reduction in the number of actors in the student loan process, essential for standardization of forms and processes. Participant reduction is integral for simplification of consolidation and income-contingent repayment processes. If single source borrowing is to be effectively implemented, a consolidated regional approach to guaranty agencies and secondary markets would present a more

EXHIBIT C
IMPLICATIONS FOR THE SIMPLIFIED FEDERAL FAMILY EDUCATION LOAN PROGRAM

PROGRAM PARTICIPANTS

- Radical reduction in the number of lenders, guarantors and secondary markets

PROGRAM FEATURES

<u>Components</u>

- One loan program, with a standard set of terms and conditions
  ----subsidized element (student borrowers)
  ----unsubsidized element (student and parent borrowers)
- One lender and servicer/one guarantor/one secondary market for all loans of an individual borrower and/or institution

<u>Interest Rates</u>

- One variable interest rate on all new loans, regardless of borrower loan history
- Prior loans allowed to be refinanced at variable rate

<u>Repayment</u>

- Income-contingent/IRS-based repayment available at the borrower's option with extended period allowed for repayment of high balance loans

PROGRAM DELIVERY

- Integrated (to the extent possible) and enhanced Title IV delivery system
  ----accepts data for all Title IV programs
  ----FAFSA utilized as loan application

- Truncated development of National Student Loan Database

Implications for Direct Lending

The implications for direct lending summarized in exhibit D on page 18 are somewhat different from those for the current program. By its very nature, direct lending assumes a significant reduction in the number of actors, the existence of one loan program, and the matching of each borrower with one entity. However, the implications for interest rates, income-contingency, IRS collections, and delivery do parallel those of the current system.

Just as in the current system, it is critical under direct lending that new loans be originated at one variable interest rate and that prior loans can be refinanced at that same rate. Similarly, income-contingency and extended repayment would be facilitated by IRS collection. Lastly, it is extremely important that a direct loan program be delivered through the existing Title IV delivery system.

This framework can be used to examine existing direct loan proposals and assess the extent to which they meet the program-wide imperatives.

Direct Lending Proposals

Four bills offered before Congress in 1991-92 define some basic design principles for direct lending. Proposals, such as H.R. 3211 (Andrews), H.R. 2336 (Petri-Gejdenson), S. 1645 (Durenburger-Fowler) and S. 1845 (Simon-Durenburger), have five common elements.

- The source of loan capital is the Federal government.
- Institutions originate the loans for their students.
- Institutions or students have a "contractual obligation" from the Federal government to receive loan funds.
- Institutions are not required to collect or service loan payments.
- Income-contingent repayment must be an option for the borrower.

In addition, all but one proposal (H.R. 3211) recommend IRS-based collections.

Only one direct loan proposal deals explicitly with delivery. Under the Simon-Durenburger plan, direct loan delivery would resemble the current Pell Grant delivery system, not Perkins Loan delivery as is commonly assumed by the financial aid community. As conceptualized by Senator Simon:

> In most cases, at the beginning of each award year, an institution would be given an initial allocation based on the previous year's loan volume. As the award year progressed, the allocation would be adjusted based on the actual number of borrowers. Institutions could draw down funds, and post the awards to students' accounts in the same way they do under the Department's current Education Payment Management System. In most cases this would improve cash flow and reduce the need to defer tuition and housing payments and offer emergency loans to students who are awaiting checks from banks.

If a direct lending program is fully integrated into the Title IV delivery system, it would permit a single structure for application processing, data management, disbursement, and reporting functions. The Pell Grant delivery system currently efficiently delivers almost $6.5 billion and a loan program which incorporates its features will permit streamlined processing. Data required for all Title IV programs should be processed through the Central Processor System (CPS) and delivered to institutions by the Department of Education. Defaulters or students who exceed annual or cumulative loan limits would be identified by a CPS subsystem. Institutions would award direct loans with Pell Grants and other Title IV aid and print promissory notes on campus.

The direct lending program as proposed would be integrated into a fully accessible student data system which contains all data necessary for both delivering funds and insuring program integrity. In the structure described above, the CPS loan subsystem would capture, retain, and track relevant loan data, thereby eliminating many of the administrative and processing steps required in the current loan system, such as student status confirmation. The subsystem would also be capable of communicating with a contractor or the IRS for the purpose of collections. A diagram of how Pell Grant delivery functions could be adapted to direct loan delivery is found on page 20.

By fully incorporating a direct lending program into the existing Pell delivery system, administrative capability requirements for institutions would not increase and might decrease.

EXHIBIT D
IMPLICATIONS FOR A DIRECT LENDING PROGRAM

PROGRAM FEATURES

<u>Components</u>

- One loan program, with a standard set of terms and conditions
  --subsidized element (student borrowers)
  --unsubsidized element (student and parent borrowers)

<u>Interest Rates</u>

- All direct loans originated at same variable interest rate
- Prior loans permitted to be refinanced at new variable rate
- Consolidation at weighed average of rates

<u>Repayment</u>

- Enhanced IRS Offset for collections
  --income contingency is built in
  --extended repayment for high balance loans is provided

PROGRAM DELIVERY

- Fully integrated Title IV delivery system
- Fully accessible student data system
- No increase in administrative capability requirements for institutions

Paperwork burden would be significantly reduced, delivery of funds would be expedited and simplified, and reporting requirements would be streamlined. Program integrity could be strengthened, since the Department of Education would be monitoring only student and schools, instead of the thousands of lenders, servicers, secondary markets, and guaranty agencies currently under their oversight.

The four bills presented before Congress each contain individual elements of the program-wide imperatives identified by the Committee, but none encompass all. For example, none consolidate the current loan programs into the single entity the Committee identified or mandate certain minimal standards for creation of an adequate data base for program administration. Consequently, all would require at least some modifications to meet the identified needs of students and institutions.

CONCLUSION

The Committee believes that the student and institution imperatives identified in this paper can be achieved through either a radically simplified current program or a properly designed direct lending program. It is also clear that the debate over direct lending is the best opportunity to date to make the loan program(s) responsive to the needs of students and institutions. The goal of the Committee is to take advantage of this opportunity by proposing to Congress and the Secretary that the current programs be radically simplified or a new direct lending program be initiated.

ADAPTING MAJOR PELL GRANT DELIVERY FUNCTIONS TO DELIVER DIRECT LOANS

Dotted Circle Indicates New Functions