

# ***Simplify and Improve Student Aid and Loan Programs***

## **Challenges:**

Federal student aid is key to providing college access to low- and middle-income students – especially now, as students and families continue to financially recover from the lingering economic downturn. The combination of federal grant, loan, and work-study programs allows for aid to be packaged to meet individual student needs. This original structure and intent of federal student aid programs remain valid today, but should be strengthened.

The core student aid programs – Pell Grants, Stafford Loans, Supplemental Educational Opportunity Grants (SEOG), Federal Work Study, Perkins Loans, and LEAP – do not duplicate each other. Rather, campus-based aid and LEAP are designed to augment the federal student aid efforts. By providing incentives for institutions to supplement federal student aid with their own matching funds, the campus-based programs actually leverage additional aid for students.

Similarly, LEAP incentivizes states to match Pell funds with state grant dollars. However, at the same time states' commitment to need-based aid bottomed out, Congress eliminated funding for LEAP. This lost not only federal incentive funding, but also the program's all important maintenance-of-effort language for state grant programs.

Maintaining incentives for colleges and states to partner with the federal government in providing need-based aid is smart federal policy. Funding should be restored for the campus-based aid programs and LEAP.

## **Recommendations:**

1. **Increase flexibility in the awarding of Pell Grants.** Replace the current system of hard annual loan limits, which gives more federal aid to those who take longer to complete, with a new system. Under such a revised system, every undergraduate student would have access to the same maximum amount of federal Pell Grants – whether they finish early, on-time, or take extra years to complete. (*Also see NAICU recommendations on [“Increase College Accessibility, Affordability, and Completion.”](#)*)

At its most basic level, students would draw down Pell funds in proportion to their progress toward completion of a baccalaureate degree. Such flexibility could also address such issues as the loss of “Summer Pell” and new initiatives on time to degree. In this way, providing more access to student aid also proposes a way to improve completion and lessen costs to students. The existing hard annual limits may need to stay in place for freshmen (or even sophomores), until they have demonstrated an ability to succeed in college.

2. **Increase the maximum allowable SEOG grant.** Increase the maximum for the third year and beyond from \$4,000 to \$7,000, to further encourage student persistence and completion.

3. **Restructure and increase access to Perkins Loans.** Support the president's proposal to restructure and significantly increase access to the Perkins Loan Program. The program has provided low-cost loans to low-income students since 1958, but funding has not been increased to meet growing student demand. Now the program is scheduled for elimination in 2014. With additional funding, the Perkins Loan Program could be transformed and expanded, with savings to the federal government.
4. **Maintain and support LEAP.** Loss of funding for LEAP rendered the maintenance-of-effort language moot, leading to a decline in states' commitment to need-based aid, and the elimination of some states' programs.
5. **Thoroughly review and update the student loan programs.** The programs should be restructured to meet the following goals: provide low cost loans to students and parents who need them; make the terms and conditions clear, and ensure the programs are efficiently administered.
  - **Loan Access: *Create flexibility in the loan program so that students who complete on-time have the same access to full federal student aid benefits as those who take longer to complete.*** Because of annual loan limits, students who complete college in four years or less are unable to borrow the maximum aggregate loan amount. As a result, they often have to borrow in the more expensive private loan market.

As an example, a student who takes five years to graduate has access to \$4,000 more in federal loan capital than a student who completes in four years. Students who are on track to complete a bachelor's degree in four years or less should be provided access to this additional borrowing. This would incentivize students to graduate sooner, and would lessen their dependence on private loans.

(Also see NAICU recommendations on "[Increase College Accessibility, Affordability, and Completion.](#)")

- **Interest Rates: *Students should benefit from current low student loan interest rates, and should be protected from excessive rates in the future.***

Current interest rates for unsubsidized and PLUS loans are higher than they would be if tied to today's market conditions. While we understand that market-based interest rates fluctuate, programs should be designed to be as low cost as is reasonably possible for students during their college-going and repayment years.

Historically, it has been difficult for Congress to set an appropriate interest rate, or to establish a process for rate-setting, that maintains a balance between providing low-cost loans to students and accommodating the nation's changing economic conditions. Linking student loan interest rates to loan market conditions, while at the same time instituting a low-interest cap, offers a possible mechanism for equity and flexibility.

In addition, the federal government should not profit from student loans at the expense of low- and middle-income borrowers.

- **Loan Terms:** *Reinstate both the in-school interest subsidy for graduate student loans and the interest-free grace period for subsidized student loans, and also eliminate the origination fees for student loans.*

Recent statutory changes, such as the elimination of in-school interest subsidy for graduate students, have made loans more expensive for certain subsets of students. Higher repayment costs can deter students from pursuing advanced or professional education – a loss to the nation in our complex and highly technological world.

The federal government should support and encourage advanced learning and skill acquisition, not make it cost-prohibitive. Low-income graduate students should be eligible for subsidized loans. They should not be forced to fund their further education with loans carrying interest rates of 6.8 and 7.9 percent that are subject to capitalization, increasing the amount that the student must ultimately repay.

Also, Congress should review the necessity of origination fees, especially at a time when the federal government is making money from the loan programs.

- **Student Debt:** *Support reasonable and legitimate efforts that encourage students to limit borrowing to the amount needed for college, and give campus financial aid officers authority to set lower borrowing limits for certain groups of students based on their program of study or course load.*

Most students have manageable student loan debt levels and repay their loans. Unfortunately, though, unwise borrowing can lead to delinquency, default, and resultant financial problems. In some cases, individual student loan debt can affect a borrower's decisions later in life. It is important that terms of repayment remain flexible and easily understood, with limits on the compounding of debt.

A student who gets a good education, minimizes borrowing, and can take advantage of reasonable repayment terms is less likely to default, even in tough economic times. Reducing the debt held by student loan borrowers is a worthy goal that benefits not only the borrower, but ultimately, society.

- **Preferred Lender List Exceptions:** *Exclude beneficial, state, or non-profit student loan programs from the preferred lender requirements so that students are aware of these programs and of their more attractive terms.*

The use of preferred lender lists was severely curtailed to eliminate “sweetheart deals” between colleges and banks, both in the former Federal Family Education Loan Program (FFELP) and in the private loan arena. While the intent of the restrictions was positive, it has left students on their own to sort out information on nonfederal loans. Also, the subsequent elimination of FFELP has made the preferred-lender rules largely irrelevant.

Under the current preferred lender rules, colleges may suggest beneficial private loans under prescribed conditions, such as rotating the names of the loan originators so there is no “top of the list” that might indicate a preferential ranking. Unfortunately, in the case of many states, this means that students are not clearly informed about nonfederal loan resources with the best conditions.

A [number of states](#) now have established their own low-cost loan programs, but they cannot be highlighted on the preferred lender list as considerably better for students without also rotating into the list much less favorable private loans. As a result, a bureaucratic rule stands in the way of the more important goal of providing information on low-cost loans to students.

- **PLUS Loans: *Review the conditions for approval of PLUS Loans.***

Recent changes in the Department of Education’s interpretation of “adverse credit history” have made the parents of dependent students ineligible for this federal source of college funding. Some of these parents had qualified for PLUS Loans in the past. The lack of funding has affected their children’s ability to continue college and, as a consequence, a number of colleges experienced drops of enrollment.

Since these loans are now all provided under the Direct Loan Program, and program losses through defaults are costs to the federal government, Congress should take a serious look at how eligibility is determined to ensure a reasonable balance between providing access for needy students and not burdening them with risky debt levels.