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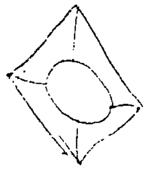

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UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF THE DEPUTY SECRETARY

July 11, 1998

TO: Interagency Interest Rate Working Group

FROM: Office of the Deputy Secretary, US Department of Education (Pauline Abernathy & Kristi Kimball)

CC: Mike Smith, David Frank, Julie Green, David Longanecker, Diane Rogers, James Kvaal, Maureen McLaughlin, Don Feuerstein, Jane Glickman, and Stephanie Babyak

RE: Recent Media Coverage on the Direct Loan Consolidation Interest Rate

Bergen Record
07/09/98; Edition: All Editions.=.2 Star B. 2 Star P. 1 Star Early; Section: NEWS; Page a19 Category: National

U.S. CUTS RATES FOR THOSE WHO MERGE STUDENT LOANS

By FROM NEWS SERVICE REPORTS

The **Education Department** is slashing interest rates for the next three months for people who want to consolidate direct student loans with federally guaranteed student loans.

Private lenders protested the move, calling it an unauthorized use of federal money that violates "the level playing field principle" allowing them to compete with the government.

Education Secretary Richard Riley made the decision July 1 that those who apply for loan consolidation or refinancing before Sept. 30 can benefit from the interest rate sliced from 8.25 percent to 7.46 percent. The department hopes the new rate _ an interim measure while Congress debates a higher education bill to reauthorize the entire student loan program _ will become law.

Education Daily
July 9, 1998 Category: Trade

Lenders Challenge ED On Consolidated Interest Rate

by Eli J. Lake
Lenders say the Education Department broke its truce with them this month by lowering interest rates for loans consolidated through the department's direct student loan (DSL) program.

A coalition of private lenders fears that bor-rowers will refinance their Family Education Loans (FELs) with the government because of the lower interest rates for DSL consolidated loans.

In a July 7 letter to Education Secretary Richard Riley, a coalition of lender organiz-a-tions said ED's decision "improperly use(s) the department's regulatory powers to engage in predatory conduct as a competitor in the mar-ket for student loans."

ED announced June 19 that the interest rate for loans consolidated through DSL would be pegged to the rates for FEL loans, which dropped to 0.8 per-cent July 1 (ED, June 25).

As of July 2, when the provision be-came ef-fective, students now apply to consolidate their FEL loans with the government at a lower interest rate than they currently pay on their student loans.

Depending on how aggressively ED markets these more attractive rates, FEL lenders could lose borrowers, destabalizing the student loan market for years to come, they claim.

Lenders reason that their participation in the FEL program is predicated on "reasonable ex-pectations regarding the life of the loan," ac-cording to the July 7 letter. But the lower in-terest rates would "erode all such expect-ations" by prompting borrowers to premat-urely trans-fer their debt from the FEL lender to the government.

You're Breaking the Law

The lenders, however, do not stop at that. They claim ED's decision violates the law prescribing appropriate administrative pro-cedures for fed-eral agencies.

Lenders claim that because the initial rates for consolidated DSL loans were subject to an ex-tensive rulemaking process, ED must use the same process if they change the rate now.

"We believe their actions are illegal," said Paul Carey, executive vice president of the Student Loan Marketing Association (SallieMae), a sig-nator of the July 7 letter.

At the same time, Carey said the lending com-m-unity has no plans to file a legal chal-lenge against ED over this provision.

An ED spokeswoman said the department be-lieves it has acted in accordance with all rele-vant law and regulations.

HEA Preempts The Rate Change

If ED were to seek public notice and com-ment, many observers predict that new changes to the Higher Education Act would preempt this rate change anyway.

H.R. 6, the pending House HEA package, re-quires ED and private lenders to set rates for consolid-ated loans through a weighted average of all the loans the borrower wishes to consol-idate. S. 1882, the Senate's HEA bill, would allow ED to write regulations for setting this inter-est rate.

"This is not a way to build good will with Con-gress. We are surprised that they have gone ahead and done this," said Jay Diskey, spokes-man for the House Education and the Work-force Committee. "We are headed into a House and Senate conference and I'm sure that we will address this."

In addition to legal concerns, the lending in-dustry estimates that the new rate change will cost the federal government $2.5 billion.

Associated Press
07-09 2:36a Category: National

Government lowers consolidation interest rate on student loans

By KALPANA SRINIVASAN
Associated Press Writer
WASHINGTON (AP) - Private lenders are complaining about a decision by the **Education Department** to slice its interest rate for direct consolidated student loans, but the agency says the move will trim hundreds and even thousands of dollars off the final tab of some people's college loans.

The Education Department decided on July 1 to cut the interest rate from 8.25 percent to 7.46 percent for those who want to consolidate their direct student loans with federally guaranteed student loans before Sept. 30. The interest rate cut means that, on average, people will save about $50 for $1,000 borrowed over the life of their loans, the department said. Someone who consolidates about $19,000 in loans will save nearly $1,000 over the standard 10-year loan period.

But private lenders, who comprise the other component of the guaranteed student loan program, worry the government will lure away students with lower interest rates. They have protested the move, calling it an unauthorized use of federal money that violates "the level playing field principle" allowing them to compete with the government.

In a letter to **Education Secretary Richard Riley**, a coalition of associations representing lenders, guarantors and secondary markets, challenged the legality of the interest rate reduction, saying it would require unauthorized spending of federal funds. Among the signers is the Student Loan Marketing Association, known as Sallie Mae, the federally chartered, privately financed corporation that is the nation's largest buyer of government-guaranteed student loans.

"We believe the proposed plan is arbitrary and capricious, an abuse of discretion, and in excess of statutory authority," the groups wrote in a letter Tuesday.

They added that "the proposed action also would destabilize the student loan markets, rupture the cooperative public/private partnership that has helped to make the American educational system available to millions, and violate the level playing field principle that the Congress and the administration have promoted."

The department has defended the new rate - an interim measure while Congress debates a higher education bill to reauthorize the entire student loan program - and hopes it eventually will become permanent.

The new rate is intended to make the system consistent, so that the interest students pay for new loans are the same as the interest they pay for direct consolidation loans, said department spokeswoman **Julie Green**.

She said the measure will "help students who are struggling to repay their loans."

2. Dow Jones News Service

07/08/98

Student Loans -2: Lawmakers Say Plan Violates Compromise

Sallie Mae and other lenders argue tha applying the interest rate to consolidation loans will unfairly allow people to refinance their old loans that carried higher interest rates at a lower rate. A consolidation loan occurs when when two or more loans are made into a single loan.

Federal law has typically required the interest rate on consolidated student loans to be an average of therate of each existing loan that is turned into a single consolidated loan.

Lawmakers warned that rules surrounding loan consolidations will be put back into place - effectively block the department from offering consolidation loans at 7.46% unless all of the underlying student loans were originally made at that rate. That is unlikely, however, because the only loans made at that rate are those issued since July 1.

"We believe any changes to the consolidation program would be inconsistent with the with the compromise which passed the House," said Rep. Bart Gordon, D-Tenn., and other top Democrats on the House Education Committee in a letter to Education Secretary Richard Riley.

The lawmakers also said they are concerned the new interest rate would result in another backlog of loan consolidation applications. Last year, the department's loan consolidation program was temporarily shut down because it had a backlog of more than 80,000 applications.

Sallie Mae officials said the department also violated federal rule-making procedures in implementing the new rate for consolidated loans.

Whenever a government agency makes a substantial policy change it typically publishes proposed rules in the Federal Register for publiccomment before issuing final rules. The Education Department simply published the lower consolidated student loan rate as a final rule without issuing it first for public comment. -Jennifer Corbett Dooren; 202-862-9200

■

Philadelphia Inquirer
July 8, 1998 Category: Local

A chance to cut down college-loan debt

The interest rate was cut for those who refinance. Critics say the move will hurt private lenders.

By James M. O'Neill
INQUIRER STAFF WRITER
Borrowers still struggling under a heavy burden of student-loan debt have a three-month opportunity to slice hundreds -- even thousands -- of dollars off what they ultimately will have to pay.

In a move that has upset some congressional Republicans and private lenders, the Clinton administration has slashed the interest rate by 0.8 of a percentage point to 7.46 percent for those who want to consolidate or refinance their student loans through the federal direct student-loan program.

Those who apply for a loan consolidation between now and Sept. 30 will save about $50 per $1,000 borrowed during the life of their loans, according to the administration. It said that an average student, who consolidates close to $19,000 of loans, would save nearly $1,000 during the standard 10-year loan. Graduate students who had even higher debt would save even more.

Republican critics contend the administration is raising false hopes for borrowers, given the department's track record handling a previous rush of applications to consolidate loans.

They also say the administration is trying to undermine the larger portion of the student-loan market -- that handled by private lenders -- because the lenders cannot match the government's unnaturally low interest rates.

The move comes as Congress debates the most equitable way to reduce rates for new student loans in a reauthorization of the Higher Education Act.

"It's a large drop in the rate, and that's a great deal for students," said Larry Zaglaniczny with the National Association of Student Financial Aid Administrators.

"This is a very important move because students are so much more burdened with debt now than they used to be," said Dave Conway, director of financial aid at St. Joseph's University.

Through the years, the federal government has shifted its approach to student financial aid, emphasizing loans rather than grants. The College Board said that low-interest, guaranteed student loans now comprised 60 percent of all federal student aid versus 40 percent in 1980-81.

The guaranteed student-loan progam has two branches. Direct student loans are administered by the government. The other and larger portion involves lending by private banks. Normally, this makes no difference to students, who get the same interest rate from either program.

But the Clinton administration controls the direct-loan portion, and by lowering the rate for consolidating loans through that program, has provided students with a better rate than they can get by consolidating through a private lender.

Key Republicans, quick to point out they do not oppose lower loan rates in theory, criticized the move, saying it is an attempt by the federal government to grab student customers from private lenders.

And they question the Department of Education's ability to handle a potential avalanche of requests to consolidate loans. Last fall, the Clinton administration had to halt the government-run loan consolidation program for four months because it could not handle a backlog of more than 80,000 consolidation requests.

Now, 81.6 million outstanding student loans are held by private lenders and another 6.9 million loans are administered directly by the federal government. The loans have an aggregate outstanding balance of $132 billion. In a given year, private lenders with loans guaranteed by the Pennsylvania Higher Education Assistance Agency write about 285,000 student loans to Pennsylvania residents alone.

"We're concerned because the entire direct-loan consolidation program is a failed program," said David Foy, spokesman for Rep. Howard McKeon, (R., Calif.), who leads the education subcommittee that monitors the loan program.

"By cutting the rates now, the Clinton administration will merely lead more students into a faulty program," Foy said. "It's like a used-car salesman reducing the interest rate on auto loans to unload a bunch of lemons. We still have no firm proof the department has taken real steps to clean up the bureaucratic mess."

Maureen A. McLaughlin, deputy assistant secretary at the U.S. Department of Education, said the department took steps to ensure a backlog did not recur. She said the company hired to handle applications had new contractual performance incentives and had been directed to hire extra staff.

But McKeon considers the new policy as "another attempt by

President Clinton to try to undercut the private lending program through the back door," Foy said.

Thomas Lustig, director of marketing for PNC Bank's education-loan center, said that if the new interest rate held beyond the three months, it certainly would affect the bank's volume of consolidated lending.

"And it would cause a significant runoff in our normal student-loan" customer base, he said.

Clinton officials counter that a private lender is not restricted from lowering its own consolidation rates. But Keith New, communications director for the Pennsylvania Higher Education Assistance Agency, the second-largest guarantor of student loans in the country, said it would be difficult for a private lender to cut its rates to the government's level because it had overhead costs the government did not face.

"We're not aware of any private lender able to match the government's new rate right now, but we do provide reliability and efficiency," New said.

He said 80 percent of consolidation applications made through PHEAA were processed within 30 days.

The Clinton administration dropped the government's consolidation rate so that it would mirror the rate approved by Congress for new direct student loans and new private-lender loans.

That new loan rate also lasts for just three months -- as a stopgap measure until Congress finishes debate and passes a larger higher-education bill to reauthorize the entire student-loan program.

Meanwhile, for the next three months, students can apply to refinance through the direct-loan program to secure the lower rate. Those who already have a pending application for a loan consolidation through the direct-loan program need not reapply. But those who previously consolidated need to reapply to get the new rates. Those interested in consolidating can call the direct-loan program at 1-800-557-7392.

Monday, July 6, 1998

Education Department Offers Interest-Rate Break on Refinanced Student Loans

By DOUGLAS LEDERMAN
WASHINGTON

The Education Department will lower for three months the interest rate paid by borrowers who refinance their student loans in the direct-loan program, despite opposition from key Republicans in Congress.

The Clinton Administration had announced the move more than a week ago, and the Education Department made it official on Thursday.

Department officials said they were dropping the rate for consolidated loans to match a new, lower rate that Congress set for guaranteed student loans in a bill approved in May. The new rate for guaranteed loans, which is eight-tenths of a percentage point below the previous rate, will be in effect through October 1.

"We're doing this to make sure more students pay the lowest possible rate," said Maureen A. McLaughlin, Deputy Assistant Secretary for policy, planning, and evaluation.

Republican lawmakers have complained that cutting the rate at which students refinance their loans in the government's direct-loan program will give that program an edge over the guaranteed-student-loan program by offering terms that banks cannot match.

Some legislators also fear that the Education Department will be unable to handle the flood of borrowers wishing to refinance their loans, given the events of a year ago. Last August, facing a backlog of 80,000 borrowers seeking to refinance their loans, the department was forced to suspend its consolidation program for four months.

Ms. McLaughlin said the department and its contractors were "working hard" to insure that they could handle the new loan volume.

15. The Chronicle of Higher Education
July 10, 1998

Education Department to Offer Lower Interest Rate to Student-Loan Consolidators

The Education Department said last week that it would lower for three months the interest rate paid by borrowers who refinance their student loans in the direct-loan program, despite opposition from key Republicans in Congress.

Department officials said they were dropping the rate for consolidated loans to match a new, lower rate that Congress set for guaranteed student loans in a bill approved in May. The new rate for guaranteed loans, which is eight-tenths of a percentage point lower than the previous rate, will be in effect through October 1.

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Republican lawmakers had complained that cutting the rate at which students refinance their loans in the government's direct-loan program would give that program an edge over the guaranteed-student-loan program, by offering terms that banks cannot match.

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Ms. McLaughlin said the department and its contractors were "working hard" to insure that they could handle the new loan volume. ■

23. Chronicle of Higher Education

June 29, 1998

Education Department Will Cut Interest Rates for Some Refinanced Student Loans

By STEPHEN BURD

WASHINGTON

The Clinton Administration is planning to offer borrowers who want to refinanc their student loans in the direct-loan program a great deal — but perhaps for a limited time only.

In a letter to Congressional leaders in June, Marshall S. Smith, the department's Acting Deputy Director, announced that beginning July 1, the Administration would slash for three months the interest rate that the government charges borrowers who consolidate their loans into direct lending.

The move, the Education Department said, is meant to allow borrowers who wish to refinance their loans the chance to benefit from the same reduced interest rates that Congress has granted new borrowers.

But the announcement angered Republican lawmakers, who saw the move as an effort to give the direct-loan program dominance in the market for consolidated student loans by offering terms that banks

cannot match. They also questioned whether the direct-loan program was ready to handle a new flood of borrowers wishing to consolidate their student loans.

"It doesn't make sense to me why they would want to overload a program that has had such problems," said Rep. Howard P. (Buck) McKeon, the California Republican who heads the House subcommittee in charge of renewing the Higher Education Act.

In a closed-door meeting last week, Mr. McKeon urged department officials to reconsider their decision, warning that proceeding could force lawmakers to shut them out of the final negotiations on a bill to renew the Higher Education Act. As of press time, the department had not backed down, but a spokeswoman there acknowledged that it was in "discussions" with Republican lawmakers over the matter.

In May, lawmakers attached to a transportation bill a provision that would lower the interest rate on new student loans in the guaranteed-loan program by eight-tenths of a percentage point for a three-month period starting July 1. The legislation, which was meant to temporarily avert an impending crisis in the program, was overwhelmingly approved by Congress and signed by the President in June.

Attaching the temporary provision on interest rates was meant to buy lawmakers more time to complete work on legislation to renew the Higher Education Act, which contains a longer-term version of the interest-rate provision that was included in the transportation bill (The Chronicle, June 5).

The transportation measure did not set the interest rate for borrowers who wish to refinance their loans during the three months. Consolidation allows students who have loans from more than one lender to combine their debts into one loan, with one monthly payment.

College lobbyists and student advocates have urged the Education Department and lawmakers to lower the rate for individuals consolidating their debts in the loan programs. They have argued that those who seek to ease their debt burden by refinancing their loans should not have to pay higher interest rates than those with new loans.

Mr. Smith wrote to lawmakers that the department would like the temporary reduction in the interest rates for borrowers who consolidate loans in the direct-loan program to be extended to those who do so in the guaranteed-loan program, as well as to be made permanent in the Higher Education Act legislation. But he noted that the department lacked the authority to reduce rates, even temporarily, for those who wished to consolidate their loans in the guaranteed program.

"We know you share our desire to reduce costs as much as possible for borrowers in both programs, and we would like to work with you to enact legislation to improve the terms of the guaranteed-loan program's Consolidation Loans to match the terms of Direct Consolidation Loans as soon as possible," Mr. Smith wrote.

But Republicans said they did not believe that lenders would be able to consolidate loans under those terms. Last year, when Congress approved a bill requiring lenders to reduce their interest rates on consolidated loans by as much as a percentage point, Sallie Mae stopped consolidating loans, saying that doing so was no longer profitable. Before that, Sallie Mae was the top private consolidator of loans.

Republican lawmakers also wondered whether the Education Department was setting up itself — and loan borrowers — for disaster. Last August, the department, citing a backlog of more than 80,000 borrowers seeking to refinance their loans into direct lending, was forced to suspend its consolidation program for four months.

Despite assurances by department officials that the program is now running well, Republican lawmakers were skeptical that it could handle a flood of new applicants attracted by the reduced rates.

"If the interest rate on consolidation loans is too low, banks will flee, and the only one left in the program will be the government," said Mr. McKeon. "If the department then is not able to handle the increased load, and the program collapses, I don't see how that will help students. ■

Education Daily
June 25, 1998 Category: Trade

ED To Lower Rates On Consolidated Direct Loans

by Eli J. Lake
The **Education Department** is lowering interest rates on loans consolidated through the direct student loan (DSL) program, a move Senate Republicans fear will overload ED's fragile loan management system.

Last week, the department announced that the interest rate on loans consolidated through the DSL program would be pegged to the interest rates for Family Education Loans (FELs), which will drop 0.8 percent July 1 (ED, May 26).

Senate Labor and Human Resources Com-mittee spokesman Joe Karpinski said this decision likely could cause backlogs for ED.

"We are concerned that the new interest rate will create an increase in volume for a system that the department is having difficulty man-aging," Karpinski said.

But ED officials deny the lower interest rate will slow down the process, under which ED combines separate loans borrowed by one student into a single account.

"As a result of significant improvements made last year, we are now consolidating more than 6,000 applications a month," an ED spokes-woman said.

ED temporarily halted its loan combination op-eration last August after congressional in-vestigations turned up some serious manage-ment weaknesses (ED, Aug. 29, 1997).

ED's woes prompted Congress to pass H.R. 2535, which allowed FEL providers to combine DSLs for one year (ED, Oct. 2, 1997).

H.R. 2535 set the interest rate on FEL con-soli-dated loans as a weighted average be-tween the loans the borrower would merge together.

The House adopted this formula in H.R. 6, its Higher Education Act (HEA) reauthorization plan, for both the FEL and DSL programs.

The Senate kept the weighted average for FEL consolida-tions but allow-ed ED to establ-ish the consol-id-ated loan inter-est rate for DSL loans through regulation.

University and student groups favor a prop-osal to peg combined loan interest rates to the in-terest rate for guaranteed loans taking effect July 1.

Last week ED took matters into its own hands, setting the interest rate for loans consolidated through DSL at the 91-day Treasury bill rate, plus 2.3 percentage points. The formula that will take effect for FEL loans next month.

In a June 19 letter to leaders of the House and Senate committees authorizing HEA, ED Act-ing Deputy Secretary **Marshall Smith** wrote, "We regret that the law does not en-sure bor-rowers in FEL receive this same benefit as borrowers consolidating Direct loans."

While student groups were thrilled with ED's decision, lenders were concerned the move would give the DSL program an unfair ad-vantage over the FEL program.

After Congress passed H.R. 2535, the nation's largest student loan lender, the Student Loan Marketing Association, discont-in-ued all such loan groupings (ED, Nov. 18, 1997).

Mark Brenner, the Education Finance Coun-cil's general counsel, said that FEL providers are at a distinct disadvantage in the loan merger market because FEL lenders must pay ED a 1.05 percentage point fee on every loan they combine.

"I'm encouraged ED wants to lower the consoli-da-tion rate for FEL, Brenner said. "The way to do this is to do away with the tax on FEL providers."

The Senate is not expected to take up HEA legislation until next month.

16. Chronicle of Higher Education-- Academe Today
June 23, 1998

White House Grants Temporary Cut in Interest Rate on Refinanced Student Loans

By STEPHEN BURD
WASHINGTON

The Clinton Administration announced on Friday that it would slash for three months the interest rate that the federal government charges borrowers who want to refinance their student loans into the direct-lending program.

The move, the Education Department said, is meant to give borrowers who wish to consolidate their student-loan debt the chance to take advantage of the same reduced interest rates that Congress has granted new borrowers. But Republican lawmakers and lenders said they saw the department's move as an effort to gain dominance over the student-loan-consolidation market by offering terms that banks could not match. They also questioned whether the department's direct-loan program was ready to handle a new flood of borrowers wishing to consolidate their student loans.

In May, lawmakers attached to a transportation bill a provision that would lower the interest rate on new student loans by 0.8 of a percentage point for a three-month period starting July 1. The legislation, which was meant to temporarily avert an impending crisis in the guaranteed-student-loan program, was overwhelmingly approved by Congress and signed into law by the President this month.

The decision to attach the temporary provision on interest rates was meant to buy lawmakers more time to complete work on legislation to renew the Higher Education Act, which contains a longer-term version of the compromise on student-loan interest rates that was included in the transportation bill. (For background, see a story that appeared in The Chronicle on June 5.)

The legislation did not set the interest rate for borrowers who consolidated their loans during that interim period. Consolidation allows students who have loans from more than one lender to combine their debts into one loan, with one monthly payment.

Student advocates and college lobbyists have urged the Education Department to lower the rate for people consolidating their debts. They have argued that those who seek to ease their debt burdens by refinancing their loans should not have to pay higher interest rates than those who take out new loans.

In a letter to Republican Congressional leaders announcing the department's decision, Marshall S. Smith, the department's Acting Deputy Director, said that the department would like the short-term reduction in interest rates for loan consolidators in the direct-loan program to be extended to the guaranteed-loan program and to be made permanent in the legislation renewing the Higher Education Act. But he noted that the department lacked the authority to reduce rates, even temporarily, for those who wished to consolidate their loans in the guaranteed program.

"We regret that the law does not ensure borrowers consolidating in the guaranteed-loan program receive this same benefit as borrowers consolidating in Direct Loans," Mr. Smith wrote. "We know you share our desire to reduce costs as much as possible for borrowers in both programs, and we would like to work with you to enact legislation to improve the terms of the guaranteed-loan program's Consolidation Loans to match the terms of Direct Consolidation Loans as soon as possible."

But Republican lawmakers said they did not believe that lenders would be able to consolidate loans under those terms. Last year, when Congress approved a bill requiring lenders to reduce their interest rates on consolidated loans by a percentage point, Sallie Mae stopped consolidating loans, stating that it could no longer make a profit on such loans. At the time, Sallie Mae was the top private consolidator of loans.

Republican lawmakers also questioned whether the department was setting itself — and borrowers — up for disaster. Last August, the department, citing a backlog of more than 80,000 borrowers seeking to consolidate multiple student loans into single direct loans, was forced to suspend its consolidation program for four months.

Despite department assurances that the program was running fine now, aides to Republican lawmakers were skeptical that it could handle a flood of new applicants excited by the reduced rates.

"This is a bit like a car dealer dropping interest rates on loans for lemons," said Jay Diskey, a spokesman for the House of Representatives Committee on Education and the Workforce. "Borrowers should beware: This is the same department that left students hanging for months last year."■

7. Money Magazine
June 1998 Page 134

Beyond The Consolidation Haze

By Kelly Smith Time Inc.

If you're looking for a way to cut student-loan costs and the buzz about loan consolidation has left you confused, that's understandable. Over the past nine months, the business of consolidating several student loans into one has changed more times than a recent grad's career plans.

To begin with, the Department of Education (DOE) temporarily stopped taking new consolidation applications last fall after a backlog of 84,000 built up. Then in November, Sallie Mae also said no to new petitions. To avert further backlogs, Congress let private lenders consolidate all government-backed loans, including direct loans, through next September and lowered the typical interest rate from about 9% to no more than 8.25%. The upshot is more convenience and lower payments now. "Consolidation is a better deal today than it was a year ago," says David Longanecker, the DOE's assistant secretary for post-secondary education.

Maybe so, but you should not let this hubbub obscure a drawback. When you consolidate student loans, you cut your payments by 10% to 40% because you stretch out your debt. However, extending your loan from the standard 10 years to as long as 30 years could more than double the total interest you'll pay for an education you've long forgotten.

So consider another way to relieve your student-loan burden. Most lenders—including Sallie Mae (800-524-9100)—offer repayment options aside from consolidation that lower your payments without substantially dragging out your loan. For example, you can opt for a "graduated repayment" schedule, under which you make low payments now and progressively higher payments over 10 years as your income presumably rises.

You can also try less formal methods. Some lenders will trim your rate by two percentage points once you make [illegible] consecutive timely payments and will shave another quarter-point if you make automatic electronic transfers from a bank account. If your lender doesn't offer any consolidation options, call the DOE (800-557-7392), the nonprofit lender Nellie Mae (800-634-9308) or a private lender who does, such as Citibank (800-934-1900) or PNC Bank (800-762-1001) ■

SallieMae

SALLIE MAE, INC.
11600 SALLIE MAE DRIVE
RESTON, VIRGINIA 20193

July 7, 1998

The Honorable Richard W. Riley
U.S. Department of Education
600 Independence Avenue, S.W.
Washington, D.C. 20202

Dear Mr. Secretary:

This letter is being sent to advise you of our serious concerns regarding the proposed action of the Department of Education with respect to interest rates on Direct Consolidation Loans. For the reasons outlined below, there are substantial grounds to conclude that the Department's action would be unlawful on both procedural and substantive grounds. Moreover, the Department's proposed action would entail an unauthorized expenditure of over $2.5 billion in federal funds, reducing retroactively the loan obligations of college and professional school graduates at the expense of future beneficiaries of government programs. The proposed action also would destabilize the student loan markets, rupture the cooperative public/private partnership that has helped to make the American educational system available to millions, and violate the level playing field principle that the Congress and the Administration have promoted.

As stated by the Department, Congress included provisions in the Transportation Equity Act for the 21st Century ("TEA") that set a temporary interest rate applicable to new student loans that are disbursed between July 1 and October 1, 1998. However, Congress chose not to apply this new rate to consolidation loans that are disbursed during that period. In doing so, Congress was aware that, under the Department's regulations, the interest rate for Direct Consolidation Loans "is equal to the bond equivalent rate of 91-day Treasury bills auctioned at the final auction held prior to ... June 1 plus 3.1 percentage points, but does not exceed 8.25 percent." Congress clearly expected that, if the Department of Education wished to change its regulations, it would follow the rulemaking procedures required under Section 457(a)(2) of the Higher Education Act ("HEA") and the Administrative Procedures Act ("APA"). Thus, the direct consolidation loan interest rate regulations initially were subject to negotiated rulemaking, and then were promulgated pursuant to the notice and comment provisions of the APA. See 59 Fed.Reg.61664 (December 1, 1994). There is no justification for a departure from such procedures here.

As you know, pending legislation that passed the House by a vote of 414 to 4 would set the interest rate on direct consolidation loans at the weighted average rates for the loans being consolidated, which is the same level as for FFEL consolidation loans. The general premise of the HEA is the maintenance of comparable terms between the FFEL and Direct Loan Programs. The pending legislation affirms that policy; whereas the Department's proposed action would contradict it. Moreover, the loan consolidation program was never intended to be a refinancing program, which it would become under the Department's proposed action. Essentially, loans disbursed prior to July 1, 1998 at the prescribed statutory rate equal to the Treasury Bill rate plus 3.10 percent would be refinanced at the Treasury Bill rate plus 2.30 percent, in violation of the statutory scheme. If Congress had intended this result, TEA would have simply revised the rate on such pre-July 1, 1998 loans retroactively, rather than establishing the lower rate prospectively only for loans made on or after July 1, 1998.

Thus, in addition to representing a substantive change in regulation without adhering to required rulemaking procedures, we believe the proposed plan is arbitrary and capricious, an abuse of discretion, and in excess of statutory authority in violation of Section 706 of the APA in that it would (i) undermine the statutory framework established for interest rates on student loans, (ii) spend valuable government assets without benefiting the vast majority of taxpayers, (iii) improperly use the Department's regulatory powers to engage in predatory conduct as a competitor in the market for student loans, (iv) subvert the FFEL Program, and (v) undermine the legitimate financial expectations of the participants in the FFEL Program, including major financial institutions and public investors.

The Department's plan would result in a huge unauthorized expenditure of taxpayer funds at the expense of future student loan borrowers. We estimate that the federal budget cost attributable to applications submitted over the next three months exceeds $2.5 billion. Clearly, it is up to Congress, not the Department, to determine how to spend limited federal funds.

Finally, we note that the Department's actions could disrupt the stability of the student loan marketplace. Lenders choose to participate in the FFEL Program based in part on reasonable expectations regarding the expected life of loans. The cost to lenders to generate the money used to fund student loans is based on similar expectations. Lenders and investors have developed those expectations based upon the historically cooperative public/private partnership that has existed in the student loan marketplace, and because of Congress' (and the Administration's) oft-stated intention to maintain two strong student loan programs. However, the Department's plan would erode all such expectations. The disruptive effect of this rate change, with no notice and opportunity to comment, would affect the confidence of the markets for years to come. This would impede the flow of fresh capital into the student loan markets, affecting the availability of loans to future students and raising the cost of the student loan program to taxpayers.

We therefore reiterate our strong opposition to the Department's proposed action. We would hope that the Department will reconsider and let the issue be resolved by the Congress. Should you go forward with the proposed action, we would be forced to consider challenging the legality of such action and taking other appropriate steps. In order to avoid a potential conflict, we would appreciate the opportunity to talk with you directly, and will contact your office to arrange such a meeting.

Sincerely,

Coalition for Student Loan Reform
Consumer Bankers Association
Education Finance Council
National Council of Higher Education Loan Programs, Inc.
SLM Holding Corporation

cc:

The Honorable William F. Goodling
Chairman
House Committee on Education and the Workforce

The Honorable William Clay
Ranking Member
House Committee on Education and the Workforce

The Honorable Howard "Buck" McKeon
Chairman
House Postsecondary Education, Training and Life-Long Learning Subcommittee

The Honorable Dale E. Kildee
Ranking Member
House Postsecondary Education, Training and Life-Long Learning Subcommittee

The Honorable Jim M. Jeffords
Chairman
Senate Committee on Labor and Human Resources

The Honorable Edward M. Kennedy
Ranking Member
Senate Committee on Labor and Human Resources

The Honorable Dan Coats
Chairman
Senate Subcommittee on Children and Families

The Honorable Christopher J. Dodd
Ranking Member
Senate Subcommittee on Children and Families

The Honorable Jacob J. Lew
Acting Director
Office of Management and Budget

UNITED STATES DEPARTMENT OF EDUCATION

Office of the Deputy Secretary
600 Independence Avenue, SW
Washington, DC 20202

Telephone Number: (202) ______ Fax Number: (202) 401-9027

FAX COVER SHEET

TO: Bob Shireman

ORGANIZATION:

PHONE: 456-2803 FAX: 456-2223

FROM: Kristi Kimball

COMMENTS: URGENT

FYI - Sallie Mae is opposing the interest rate reduction in Direct Consolidation loans on a number of legal points. Our lawyers are looking at this letter now.

TOTAL PAGES (Including Cover): 5

AMERICAN COUNCIL ON EDUCATION
DIVISION OF GOVERNMENT AND PUBLIC AFFAIRS

One Dupont Circle, NW, Suite 835, Washington, DC 20036
Office: (202) 939-9355 Fax: (202) 833-4762
http://www.acenet.edu

FAX TRANSMITTAL FORM

To: Bob Shireman

Fax Number: 456 - 2223

Date: July 6

Number of pages (including cover):

From: DIVISION STAFF

- ☐ TERRY W. HARTLE, Senior Vice President
- ☐ SHELDON E. STEINBACH, Vice President & General Counsel
- ☒ BECKY H. TIMMONS, Director, Congressional Relations
- ☐ JACQUELINE E. KING, Director, Federal Policy Analysis
- ☐ DIANE C. HAMPTON, Legislative Analyst
- ☐ WANDA FORD SMITH, Division Office Manager
- ☐ PAUL F. MASSEY, Federal Relations Associate
- ☐ BETH W. QUEVLI, Governmental Relations Assistant
- ☐ ROSA M. LOTT-HAWKINS, Administrative Assistant

Message:

- ☐ For SIGN ON by:
- ☐ Please Respond by:
- ☐ URGENT
- ☐ Per Our Conversation
- ☐ Per Your Request
- ☐ Please Review & Comment
- ☒ For Your Information

American Council on Education

Office of the President

July 6, 1998

The Honorable William F. Goodling
U.S. House of Representatives
2181 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Goodling:

I write on behalf of the undersigned associations to express our support for reducing the interest rate of direct consolidation loans to the level established by the bipartisan congressional interest rate agreement. We are pleased that the Administration has adopted this rate for direct consolidation loans effective July 1, 1998.

In the last decade, student borrowing to finance higher education has increased dramatically. Because of this trend, it has been a central goal of all higher education associations to ensure that borrowers have ready access to federal student loans with the best terms and conditions. We believe that the congressional decision to lower the borrower interest rate to 7.43 percent in the student loan program creates an unprecedented opportunity to reduce the cost of student loans for those students with the greatest levels of educational debt. The extension of this rate to borrowers in repayment removes a statutory barrier that has prevented these individuals from enjoying the benefits of a thriving economy that has afforded other consumers a chance to lower their debt payments.

The impact of such a sharp reduction in the interest rate during repayment can be profound. For example, a borrower who owes $40,000 will save over $2,000 on a ten-year repayment schedule by consolidating her loans at the lower rate. If she elects to repay on a twenty-year schedule, the savings would amount to nearly $5,000.

While we support the decision to lower the interest rate for consolidated loans, we are acutely aware that this change may produce a surge in consolidation applications that could overwhelm the capacity of the Department of Education's contractor to service the loans. Indeed, just such a servicing failure caused massive disruption last year. We have urged the Department to take proactive steps to avoid repeating a similar failure, such as contracting with the student loan industry to bring private sector expertise

One Dupont Circle NW, Suite 800, Washington, DC 20036-1193
Telephone: (202) 939 9310 · Fax: (202) 659-2212

to the task, and increasing the resources available at the federal servicing center to encourage smooth and effective administration.

Despite our concerns about servicing, we believe that the decision to offer student borrowers the lowest possible interest rate is commendable and will help a large number of recent college graduates reduce the cost of repaying their loans.

We recognize that this temporary solution will be subject to review as part of the reauthorization process. We will continue to work with you and the Administration to make certain that the best terms and conditions are available to borrowers in both the FFELP and direct loan programs.

Thank you again for your leadership which has made this benefit possible.

Sincerely,

Stanley O. Ikenberry

Stanley O. Ikenberry
President

On behalf of:
American Association of Community Colleges
American Association of State Colleges and Universities
American Council on Education
Association of American Universities
Association of Governing Boards of Universities and Colleges
Association of Jesuit Colleges and Universities
The College Fund/UNCF
Council of Graduate Schools
Council of Independent Colleges
National Association for Equal Opportunity in Higher Education
National Association of College and University Business Officers
National Association of Graduate-Professional Students
National Association of Independent Colleges and Universities
National Association of State Universities and Land-Grant Colleges
National Association of Student Financial Aid Administrators
United States Student Association
U.S. PIRG

SECRETARY RILEY'S MEETING WITH HIGHER EDUCATION ORGANIZATIONS REGARDING LOAN CONSOLIDATION

WEDNESDAY, JULY 1
5:30 PM

ATTENDEES

CONFIRMED:

Terry Hartle
American Council on Education (ACE)

Barmak Nissirian
American Association of State Colleges and Universities (AASCU)

Jamie Pueschel and Sarita Gupta
United States Student Association (USSA)

Ivan Frishberg
United States Public Interest Research Group (U.S. PIRG)

David Pierce and David Baime
American Association of Community Colleges (AACC)

TENTATIVE:
American Association of Universities (AAU) John Vaughan +
National Association of Graduate-Professional Students (NAGPS) Michael Augusta

7/1/98 11 a.m.

- Betts from Ft. Myers
  - Chris @ beach
  - Collie also gone
  - Dale in Mich.

· Pauline after talking Secy:

  > Ready to go if Kenn & Wildee...

  → Kenn call Wildee

  > Want they than cl. Goppell — 458
  'we gave strongest possible assurance'

  > Limit dig-?

Info for senators:

· Daschle - expects the are on drop;
  not much from his G.A.

Congress of the United States
House of Representatives
Washington, DC 20515

June 25, 1998

1998 JUN 30 A 9:23

The Honorable Richard Riley
Secretary of Education
U.S. Department of Education
400 Maryland Ave., SW
Room 4181
Washington, DC 20202

Dear Secretary Riley:

We write to urge you to reconsider the interest rate change the Department of Education recently announced for Direct Consolidation Loans issued after June 30, 1998.

We are deeply concerned that this decision will create a flood of applications, once again overloading the center that processes Direct Consolidation loan requests. Unfortunately, ten months ago the Education Department was forced to suspend the acceptance of new Direct Consolidation loan applications for three months. As a result, tens of thousands of student loan borrowers suffered unnecessary delays, inconvenience, and cost.

This backlog of some 80,000 Direct Consolidation loan requests was cleared only because the majority of the affected borrowers gave up on their attempts to consolidate their loans through the Federal Direct Loan Program. The incident prompted Congress to enact emergency legislation to allow the affected borrowers to consolidate their loans with private lenders.

Though we are sure the Department does not wish to repeat this unfortunate episode, we fear that many of the factors that led to last year's Direct Consolidation loan processing difficulties remain in place. Reports persist of operational problems at the origination center. In fact, just this past April, the GAO issued a report identifying several serious recurring problems with the Direct Loan Consolidation Program such as charging one borrower for a second borrower's loan, flawed transfer data, and inaccurate payments to lenders. We are concerned that another processing backlog will develop from any interest rate change.

As you know, after more than a year of work, Congress was able to develop a bipartisan solution to the 1998 interest rate problem. We believe any changes to the consolidation program would be inconsistent the with compromise which passed the House by a vote of 414-4. This most recent adjustment would force three changes in a few months, creating significant borrower confusion.

We know that, like us, you are concerned about the interests of current and former college students. We believe those interests would be better served if you reconsidered the Direct Consolidation loan interest rate. Thank you for your careful consideration of these concerns.

Sincerely,

Bart Gordon
Member of Congress

Charlie Stenholm
Charles Stenholm
Member of Congress

Earl Pomeroy
Earl Pomeroy
Member of Congress

Vic Fazio
Vic Fazio
Member of Congress

cc: The Honorable Bill Goodling
The Honorable Bill Clay
The Honorable Howard "Buck" McKeon
The Honorable Dale Kildee

Mike -
FYI. Money is actually discouraging consolidation.
- Pauline

7. Money Magazine

June 1998 Page 134

Beyond The Consolidation Haze

By Kelly Smith Time Inc.

If you're looking for a way to cut student-loan costs and the buzz about loan consolidation has left you confused, that's understandable. Over the past nine months, the business of consolidating several student loans into one has changed more times than a recent grad's career plans.

To begin with, the **Department of Education** (DOE) temporarily stopped taking new consolidation applications last fall after a backlog of 84,000 built up. Then in November, Sallie Mae also said no to new petitions. To avert further backlogs, Congress let private lenders consolidate all government-backed loans, including direct loans, through next September and lowered the typical interest rate from about 9% to no more than 8.25%. The upshot is more convenience and lower payments now. "Consolidation is a better deal today than it was a year ago," says **David Longanecker**, the DOE's assistant secretary for post-secondary education.

Maybe so, but you should not let this hubbub obscure a drawback. When you consolidate student loans, you cut your payments by 10% to 40% because you stretch out your debt. However, extending your loan from the standard 10 years to as long as 30 years could more than double the total interest you'll pay for an education you've long forgotten.

So consider another way to relieve your student-loan burden. Most lenders—including Sallie Mae (800-524-9100)—offer repayment options aside from consolidation that lower your payments without substantially dragging out your loan. For example, you can opt for a "graduated repayment" schedule, under which you make low payments now and progressively higher payments over 10 years as your income presumably rises.

You can also try less formal methods. Some lenders will trim your rate by two percentage points once you make 48 consecutive timely payments and will shave another quarter-point if you make automatic electronic transfers from a bank account. If your lender doesn't offer any consolidation options, call the DOE (800-557-7392), the nonprofit lender Nellie Mae (800-634-9308) or a private lender who does, such as Citibank (800-934-1900) or PNC Bank (800-762-1001)■

~~You don't have to start out this year?~~ — No.

MO

6/30/98

> Canedy → Advise Dems, make sure comfortable –
> Capacity
> Comm/Outreach
> Q&A
> Budget

Canedy

- Vic - prob. nothing doable
- Hatfield - getting back on cs relay

forced ~~letters~~ "With you 100%"...

* Dems

Bob ☐ - Students, Ivan,
☐ - Comps — Terry, Ped, Bormak, Betts

Tom Kelly or Scott P. ☐ - Dems

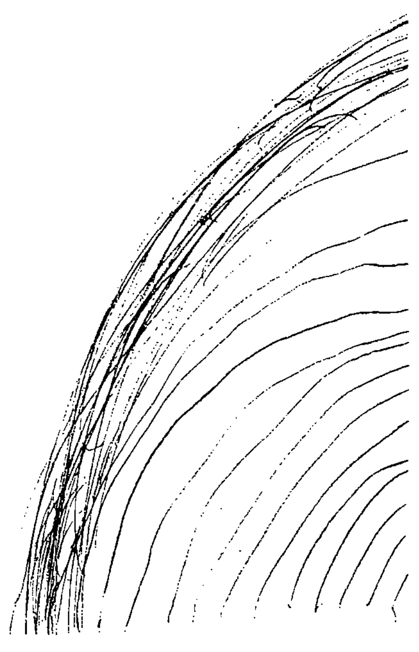
} cab relay
~~Agg~~ aggressive support & defense...

- Congress - "we didn't hear from anyone"

- support
&
- ~~defense~~ defense / 458 etc.

Capacity

- ~~3000~~/week now
  - 3000/week can do now.
  - 4000/week by Oct. / w/o prob.
- Need to be relieved from 100% redundancy
- CPSC all. canvassed. - DLs
- GAs, state of each



Plan

- Groups * - happen to their request... - helpful ... - problems than case parts...
  - delays...

- ... * Long-run solution... ... current ...

☐ Drafts from ED

Costs

$7 million so far, $7 more if no surge

$96/loan avg.

- Transfer $ 1% from Pell

CBO: will not Δ projections of ... ... policy ... ...
... the mix...

Fed cost		CBO
2.3 w/ banks 3.1 w/fee	$1.2 billion	$1.4
no fee 2.8 for banks	1.8

9X ...
50 → 33 bp

5 → 3 yrs. 1.1

CBO:

TWO 14 consolidation?

Old contract

8.14 for ~~orig.~~ alt. / $60 for schools.
$24 for consolidations

$78 - $113 , avg. $96 now...

desubsidization: modify a loan → subsidy.
= new loans, but "modifying debt"

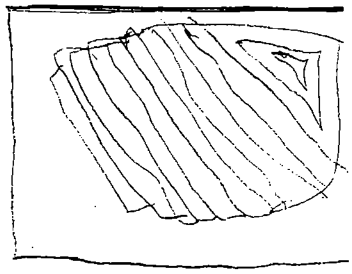
Barmak

@ the mtg - they
what I said was misunderstood.
- 1 paradoxically
① wasn't a one-sided slam...
② ~~they~~ tried to calm ~~them~~ down, let it happen...

Loan industry doom & gloom: won't be a major erosion,
because only some who go thru whole process
will actually finish...

Those de Napoli sent the ? offer in reply...
(~~not~~ backtracking?)

Hope they'll do s
"Obviously we'll support you to the maximum extent"

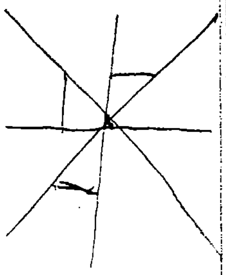


- "Dattie" said i rates not coming down...

- We will be supportive, but I want you to make sure they go thru the redevelopment steps...

Word on the street that there is a budding bldg war, unreliable person

Short of that... will be supportive



I concede: If not for our proposal, (I more) timing, etc.
we admit be sitting pretty...

50% more immediately?

Barrack: Then its a win-win proposition.

This is high risk and I understand the (downside). I assure you they (claims) will be with you...

Wilder

- Generic agmt;
McKean thinks it violates...
"Will do all we can do blacklist..."
and sail thru the House...
~~Strongly~~ Called

"HEA is more impt"

- potential to derail things that are going on in HEA...

Mike Smith: - Wilder drew it and threaten a lot of things...
- McKean will do anything he can to stop it...
- Andrews also worried it will get in the way of getting thru HEA...

* Hers running away from the issue.

(Dupont - we're squeezing stuff out of them; no impact on HEA...

HEA / Mike Smith

~~Spell~~ PBO — first one in the govt... > V.P.

* Distance Cong.

* Avg fees?

* H.H.

- Credibility ~~of~~ how much does it suffer.

- Chr: substantial

- Fleming: mitigated by Mell-Art deal...

- BMA lead

224-7959 - usa
h: 268-4921

- Michael Myers -

- If we do it, clean ~~and~~ defined...
if it causes a [illegible] ...
a bad [illegible] ...

Kennedy...

- Jerry Cavanaugh

Scott/ - Scott doesn't see how we could do anything but cut the rate...
- for today's limited [illegible]...

political/strategic read...

UNITED STATES DEPARTMENT OF EDUCATION

THE DEPUTY SECRETARY

June 19, 1998

Honorable James M. Jeffords
Chairman
Committee on Labor and Human Resources
United States Senate
Washington, DC 20510

Dear Senator Jeffords:

I am writing to share with you the Department of Education's plans relating to student loan consolidation interest rates. I am sending identical letters to Senator Kennedy and Representatives McKeon, Kildee, Goodling and Clay as well.

As you know, the temporary student loan interest rate provisions contained in the Transportation Equity Act for the 21st Century recently signed into law apply to new Stafford student loans made under the Direct Loan and Federal Family Education Loan (FFEL) programs between July 1 and October 1, 1998, but not to Consolidation Loans made under either program. Thus, the new law does not alter the loan consolidation terms established under the Emergency Student Loan Consolidation Act of 1997 and the Higher Education Act, under which Direct Consolidation Loan interest rates are established by regulation and FFEL Consolidation Loan interest rates are set in statute. At present, the Department's regulations set the Direct Consolidation Loan interest rate at the interest rate for Stafford Loans. The Emergency Student Loan Consolidation Act of 1997 improved the statutory terms of FFEL Consolidation Loans to match the terms of Direct Consolidation Loans through July 1, 1998, but did not provide for the maximum FFEL Consolidation Loan rate to decline on July 1 with the new Stafford Loan interest rate.

Thus, the 1997 Act provided for a differential between Direct and FFEL Consolidation Loan interest rates during the last quarter of this fiscal year. Both the Administration's and CBO's baselines reflect this differential. In both, the Direct Consolidation Loan interest rate drops on July 1 to match the new Stafford Loan rate while the FFEL Consolidation Loan interest rate remains by law at the 91-day Treasury Bill rate plus 3.1 percentage points for the remainder of the fiscal year, after which the FFEL Consolidation Loan rate reverts by law to the weighted average of the underlying loans, rounded up to the nearest whole percentage point.

Accordingly, consistent with these budget baselines and current policy, the interest rate on new Direct Consolidation Loans will drop on July 1 when the Stafford Loan rate drops to the 91-day Treasury Bill rate plus 2.3 percentage points, providing borrowers with an opportunity to consolidate their outstanding loans at the new lower student loan rate. We regret that the law does not ensure borrowers consolidating in FFEL receive this same benefit as borrowers consolidating in Direct Loans, which is why the Administration proposed that the reauthorization of the Higher Education Act level the playing field by also setting the maximum FFEL consolidation rate at the new Stafford loan rate. We know you share our desire to reduce costs as much as possible for borrowers in both programs, and we would like to work with you to enact legislation to improve the terms of FFEL Consolidation Loans to match the terms of Direct Consolidation Loans as soon as possible. We would be pleased to meet with you to discuss this important issue.

Sincerely,

Marshall S. Smith

Marshall S. Smith
Acting Deputy Secretary

THE WHITE HOUSE

WASHINGTON

Staff

- Michael

Mike Myers

- Marianna ... +

- Chris - Manzur ... Kildee

- US, SOA, Tom, Dan, Dale, Pastor.

Christopher's "generic agmt" Kildee

Goal: maintain peace

, is a deal for students

" would create an awful lot of problems

in the conference; not necessarily...

Direct vs. Guaranteed...

401-3093

Wally

SEC. 458 - You have to do a better

job giving us better arguments,

policy pts on 458

- Accuracy of Role ⊕

- Volume vs.

"politics vs. merits of $$"

(a request, not a accounting - F)

The internal Q&As will be distributed to:

- Administration officials (WH, OS, ODS, OPE, OPA, OLCA, etc.)

The one-page fact sheet will be distributed to:

- Administration officials (WH, OS, ODS, OPE, OPA, OLCA, etc.)
- Media as appropriate
- Hill as appropriate
- Higher Education groups as appropriate

The borrower Q&As will be distributed to:

- Administration officials (WH, OS, ODS, OPE, OPA, OLCA, etc.)
- Media as appropriate
- Hill as appropriate
- Higher Education groups as appropriate
- EDS
- PIC (800-4-FED-AID)
- CDSI
- CAMs
- Department's Direct Loan Web Page

DRAFT

June 30, 8:30 AM

Meeting Demand for Direct Loan Consolidations

The Department of Education is preparing to meet a possible increase in demand for direct loan consolidations after July 1.

The direct loan consolidation program has been greatly improved. The Department has taken strong actions to re-design the direct loan consolidation process. The most important improvements to the loan consolidation process include:

- **Adding contractual, performance-based incentives;**
- **Re-engineering the process to verify loan balances** by improving the speed and accuracy of the process by which the loan holder certifies the loan balances and encouraging the electronic transfer of information;
- **Improving data accuracy** by contacting the borrower more frequently, manually entering the data on each application twice and manually resolving any discrepancies, and using the National Student Loan Data System to verify loan information earlier in the application process;
- **Creating new managerial controls and monitoring mechanisms** such as improved tracking of applicant information and new management reports; and
- **Hiring new staff and adding expertise** in financial services and student loan operations.

The loan consolidation program has put last fall's problems behind it and is now running smoothly. Our loan consolidation contractor:

- Has completed processing all applications that were received prior to December 1997;
- Is promptly processing the applications it has received this year and has met its performance targets; and
- Is now processing consolidations well within the industry standard of 60 to 90 days.

EDS is prepared to handle some additional volume.

- This year, EDS has processed roughly *8,000 consolidations each month.*
- EDS has some excess capacity now and, in preparation for a possible increase in volume, it expanded its capacity further to 12,000 consolidations each month.
- By October 1, this capacity could be expanded to 16,000 consolidations each month.

The Department is exploring other means of obtaining additional capacity to process direct loan consolidations, should the need arise.

- We are looking closely at commercial organizations with closely-related experience and a proven track record of performance.

→ expand

DRAFT

June 30, 8:30 AM

Questions and Answers for Students

Student Loan Consolidation Interest Rates
July 1, 1998

Note: These draft Q&As are based on the assumption that the interest rate for direct consolidation loans is reduced to 91-day T-Bill plus 2.3 on July 1. If the rate is not reduced, these Q&As will need to be substantially revised.

What will be the interest rate on new consolidation loans through the Direct Loan program between July 1st and October 1st?

All new consolidation loans for students made on or after July 1 and before October 1, 1998, through the Direct Loan program will have an interest rate of 7.46 percent.

All new consolidation loans for parents (PLUS loans) made on or after July 1 and before October 1, 1998, through the Direct Loan program will have an interest rate of 8.26 percent.

This interest rate for student loans is equal to the 91-day Treasury bond plus 2.3 percentage points, with a maximum rate of 8.25 percent. The interest rate formula for PLUS loans is equal to the 91-day Treasury bond plus 3.1 percentage points, with a maximum rate of 9 percent. The interest rate is re-computed annually based upon this formula. However, the formula will not change over the life of the loan.

If I have a pending application for a loan consolidation through the Direct Loan program, do I need to re-apply to get the new, lower interest rate?

new law passes

If the Direct Loan program pays off your first loan or receives your application between July 1 and ~~October 1~~, you will receive this new, low interest rate. If you have already applied for a consolidation loan but the consolidation has not yet been completed, you do not need to re-apply in order to receive this interest rate. *(What if borrower applies 6/30 and gets consolidated 10/2?)*

What will the interest rate be on new consolidation loans made on or after October 1st under the Direct Loan program?

The Clinton Administration strongly supports making this new rate permanent and available under both the Direct Loan and the FFEL programs. Congress is expected to pass legislation before October 1, 1998. As a result, you should check back with us for further updates.

If I have already received a loan consolidation through the Direct Loan program, do I need to re-apply to get the new, lower interest rate?

Yes. This interest rate change applies only to *new* consolidation loans and does not affect existing consolidation loans. If you have previously received a loan consolidation, you must apply to re-consolidate in order to receive this new, lower interest rate.

How do I re-consolidate my direct consolidation loan?

The Department has established special procedures to process re-consolidation requests. If you already hold a consolidation loan from the Direct Loan program, do not wish to add any non-direct loans (such as a FFEL loan) to the consolidation loan, and are not applying for a joint or spousal consolidation, you may call 1-800-XXX-XXXX. (Servicing/Utica number) If you are not sure whether or not your student loan is a direct loan, an operator at this number can tell you.

If you do not meet all of these conditions, please call 1-800-XXX-XXXX. (LOC/Montgomery number) An application will be mailed to you. Loan consolidation applications will also be available for download on the Department's web site, www.ed.gov, soon.

What will be the interest rate on new consolidation loans made under the Federal Family Education Loan (FFEL) program between July 1st and October 1st?

All new consolidation loans for students made before October 1, 1998, through the FFEL program will have a maximum interest rate of 8.25 percent.

Are PLUS loans different??

This interest rate is based upon a formula equal to the 91-day Treasury bond plus 3.1 percentage points, with a maximum rate of 8.25 percent. The interest rate is re-computed annually based upon this formula.

These loan terms were set in law by Congress in the Emergency Consolidation Act last fall. The provisions of this act expire on September 30, 1998.

What will the interest rate be on new consolidation loans made on or after October 1st under the FFEL program?

The Clinton Administration strongly supports making the new interest rate formula permanent and available under both the Direct Loan and the FFEL programs. Congress is expected to pass legsilation before October 1, 1998. As a result, you should check back with us for further updates.

Why is the interest rate on direct consolidation loans dropping?

By regulation, the interest rate on new consolidation loans through the Direct Loan program is the same as the interest rate on first-time Direct Loans. Therefore, the interest rate reduction on new students beginning on July 1, 1998 -- passed by Congress in 1993 and amended this year -- applies to direct loan consolidations as well.

Why isn't the interest rate on FFEL consolidation loans dropping?

How much money will I save as a result of the new interest rate?

Who should I contact to receive the new consolidation interest rate? Where can I get an application?

To apply for a loan consolidation through the Direct Loan program, please call 1-800-XXX-XXXX. (Montgomery number) An application will be mailed to you. Loan consolidation applications will also be available for download on the Department's web site, www.ed.gov, soon.

If you already hold a consolidation loan from the Direct Loan program and do not wish to add any loans to the consolidation loan, you are eligible for the newly-established, special loan consolidation process. Please call 1-800-XXX-XXXX. (Utica number)

How long will it take to process my consolidation application?

Loan consolidation is a lengthy process, largely because we must verify your loan balance with each of your lenders. The industry standard is 60 to 90 days.

The lower interest rates for new direct consolidation loans may result in increased interest for loan consolidations. We have expanded processing capacity to handle the increased volume of requests. However, if the demand for consolidations exceeds our expectations, it may temporarily take longer than usual to process applications. However, as long as we receive your application between July 1 and September 30, 1998, you will receive the new, low interest rate.

DRAFT

June 30, 8:30 AM

FOR INTERNAL USE ONLY
Questions and Answers

Student Loan Consolidation Interest Rates
July 1, 1998

Note: These draft Q&As are based on the assumption that the interest rate for direct consolidation loans is reduced to 91-day T-Bill plus 2.3 on July 1. If the rate is not reduced, these Q&As will need to be substantially revised.

What volume of loan applications do you expect to receive if the interest rate on new direct consolidation loans is reduced after July 1?

After July 1, there may be increased interest in direct consolidation loans, but it is hard to predict how much.

There is a precedent for this situation: in 1997, direct loan consolidation loans were cheaper than federally-guaranteed consolidations loans (their interest rate was *0.80 percentage points* lower, on average.) In 1997, we received *about 12,000 applications each month.* So far this year, under equal interest rates for both programs, we have received *about 10,000 applications each month* (including applications that were later withdrawn or deactivated).

We are preparing to handle additional volume, although we do not know if it will materialize.

How will the Department handle the increased demand for consolidation loans?

It is possible that we will receive more applications for direct consolidation loans, but it is hard to predict how many more.

Our loan consolidation contractor, EDS, has some excess capacity now and is hiring additional staff to expand its capacity further. We are also exploring other means of obtaining additional capacity, should the need arise.

How many consolidation applications does the Department process each week?

The Department's loan consolidation contractor has *processed about 2,000 applications each week.*

How much additional loan volume can the Department handle without causing a backlog?

EDS is capable of processing 3,000 consolidations each week. By October 1, EDS could be capable of processing 4,000 consolidations each week.

Is the backlog from last fall gone now?

Yes. The Department has materially strengthened the direct loan consolidation program and completed processing all applications that were a part of the backlog. The loan consolidation program is now running smoothly.

The Department and EDS have made many improvements, including:

- Adding performance-based incentives to EDS's contract;
- Re-engineering the process to verify loan balances;
- Improving data accuracy;
- Creating new managerial controls and monitoring mechanisms; and
- Hiring new staff and adding expertise.

EDS has met its performance targets and is now processing consolidations well within the industry standard of 60 to 90 days.

Why did the Department decide to drop the rate on direct consolidation loans? Why on July 1st?

By regulation, the interest rate on new consolidation loans through the Direct Loan program is the same as the interest rate on new direct loans. The July 1st interest rate reduction on new student loans -- originally passed by Congress in 1993 and amended in June -- applies to direct loan consolidations, as well.

Both the Administration's and the Congressional Budget Office's budget assumptions included this new, lower interest rate.

Therefore, the reduction in direct loan consolidation interest rates was simply in accordance with current policy and budget assumptions.

Why did the Department make this unilateral decision without consulting Congress?

First, this was not a discretionary decision made by the Department. By regulation, the interest rate on new direct consolidation loans must be the same as that on first-time direct loans. The reduction in the loan consolidation interest rate is simply in accordance with this longstanding policy as well as Administration and CBO budget assumptions. Congress could have changed this regulation while setting the interest rate last month, but chose not to.

Second, the Department did consult with Congress, as reported recently in *The Chronicle of Higher Education*. We also discussed this issue in detail with student groups, higher education groups, and OMB.

Does anyone else agree with your decision? (Students, Higher Ed groups, Congress?)

I cannot speak on behalf of those individuals or organizations and would refer you to them for comment. I could provide you with a letter signed by the U.S. Students Association, U.S. PIRG, and the National Association of Graduate and Professional Students supporting the lower interest rate.

Is this an attempt to steal loan volume from the FFEL program and convert it to the Direct Loan program?

Absolutely not. Again, this reduction is simply in accordance with current policy and budget assumptions.

We regret that the law does not ensure borrowers consolidating in FFEL receive this same benefit as borrowers consolidating in Direct Loans, which is why the Administration proposed that the reauthorization of the Higher Education Act level the playing field by also setting the maximum FFEL consolidation rate at the new Stafford loan rate. We are anxious to work with Congress to lower interest rates in both programs.

How much money does it cost the Department to process each consolidation loan?

On average, it costs the Department $96 for each consolidation loan. However, this number varies month-to-month and loan-to-loan since EDS is compensated based upon performance.

- Do we lose $$?
- How does admin cost (long-run?)

What part of the Department's budget is used to pay for loan consolidation?

EDS's is compensated from the Department's contract funds (not Section 458).

- How much cost per cons.
- wasn't there 16 mt.?
- Where are you getting that 6

- How many can you do.

Sample Payments for Borrowers Repaying in 1998-99 under Compromise Proposal and Pre-SLRA Interest Rates

The Proposal Includes a .8% Reduction in Student Repayment Interest Rates

Type of borrower	Debt	Pmts under 91 day+3.1% [1]	Pmts under 91 day+2.3% [2]	Cash Difference	NPV Difference
4 yr public	$12,000	$18,086	$17,450	$635	$465
4 yr private	$16,000	$24,114	$23,267	$847	$620
Masters	$20,000	$30,143	$29,084	$1,059	$775
Professional	$60,000	$90,429	$87,252	$3,177	$2,325
DL Consol (Average Loan)	$18,55[illegible]	$27,959	$26,977	$982	$719
DL Consol (Average for Defaulters)	$7,237	$10,908	$10,525	$383	$281
DL Consol (Average for Non-Defaulters)	$26,094	$39,327	$37,945	$1,361	$1,012
DL Consol ($100,000 Professional Student Debt)	$100,000	$150,714	$145,420	$5,294	$3,876

Assumes ten year repayment plan; debt equals amount upon entering repayment.

Borrowers taking unsubsidized nonconsolidated loans would have additional savings from lower in-school interest rates.

[1] Student interest rate under pre-SLRA terms is projected to be 8.25%
[2] Student interest rate under compromise proposal is projected to be 7.46%

Budget Service
6/29/98

OPTIONAL FORM 99 (7-90)

FAX TRANSMITTAL # of pages ▸ 1

To Kathy Shade	From William Graham
Dept./Agency	Phone #
Fax #	Fax #

NSN 7540-01-317-7368 5099-101 GENERAL SERVICES ADMINISTRATION

United States Student Association • U.S. PIRG
National Association of Graduate and Professional Students

June 25, 1998

Dear President Clinton:

On behalf of the U.S. Student Association (USSA), the U.S. PIRG's Higher Education Project, and the National Association of Graduate and Professional Students (NAGPS) we want to express our strong appreciation for your decision to ensure that students who consolidate their student loans into direct lending will have available to them the same reduced interest rate already approved by both the House and the Senate for new Stafford loans. We thank you for listening to student's concerns regarding the interest rate on consolidation loans and acting to address our needs.

As you well understand, students are currently overwhelmed by ever increasing debt load. Students seeking consolidation are most often those with the greatest debt, and, therefore those struggling the hardest to make interest payments upon graduation. As we have stated repeatedly over the last two years, reducing the interest rates on all student loans, including consolidation loans, has been a top priority for students. Your decision to use regulatory authority to guarantee to students the ability to consolidate their loans and still take advantage of the 0.8% interest rate reduction approved by Congress reflects your prioritization of students on this issue and represents sound public policy. We understand that guaranteeing the reduced rate for direct lending consolidation may potentially bring about servicing problems or create a backlog in processing new direct consolidation loans. However, as we have expressed to your Administration, we believe it would be wrong to let the possibility of disruptions in servicing outweigh the significant benefits to be realized for students so desperately in need of lower interest payments. It is also our hope that with this decision will come concerted efforts to improve servicing in direct loans and to prevent such potential problems from arising.

Again, we thank you for your continuing efforts on behalf of students.

Sincerely,

Sarita Gupta, President, U.S. Student Association
Ivan Frishberg, U.S. PIRG's Higher Education Project
Michael Agusta, National Association of Graduate and Professional Students

Status of Loan Consolidation Applications Received by EDS Since December 1, 1997

Number of Consolidation Applications*	Cumulative Through 06/12/98	Change Since Last Bi-Weekly Report (05/29/98)
Accepted	61,677	+4,276
In Process	17,751	+302
Step 1: Obtaining lender information	6,683	-191
Step 2: In underwriting process	1,533	-2,131
Step 3: Obtaining signed promissory note from borrower	6,595	+2,468
Step 4: In ICR Process**	2,940	+156
Deactivated	6,238	+209
Ineligible/Withdrawn	1,839	+47
Completed (Consolidated)	35,849	+3,718

OPTIONAL FORM 99 (7-90)
FAX TRANSMITTAL # of pages ▸ 1
To Bob Shireman
From Barry Goldstein
Dept/Agency NEC
Phone # 708-6522
Fax # 456-2223
Fax #
NSN 7540-01-317-7368 5099-101 GENERAL SERVICES ADMINISTRATION

- The Department's contractor, EDS, resumed accepting new consolidation applications on December 1, 1997.
- An accepted application can be deactivated at any stage in the process if a borrower who has provided incomplete information fails to respond within 21 days to a request for additional information. The application can be reactivated when the borrower provides the requested information.
- The change since the last bi-weekly report can be negative if more applications move to the next step than entered a step.

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* The figures include only applications that have been reviewed and accepted as complete.

** These are applications for borrowers who have selected or have been assigned the Income Contingent Repayment (ICR) option and are awaiting the approval of the waiver from the IRS or receipt of alternative documentation from the borrower.

U.S. Department of Education
June 26, 1998

ROBERT E. ANDREWS
FIRST DISTRICT, NEW JERSEY

COMMITTEE:
EDUCATION AND THE WORKPLACE
SUBCOMMITTEES:
WORKFORCE PROTECTIONS
POST SECONDARY EDUCATION, TRAINING AND LIFELONG LEARNING

COMMITTEE:
INTERNATIONAL RELATIONS
SUBCOMMITTEES:
ASIA AND THE PACIFIC
WESTERN HEMISPHERE

Congress of the United States
House of Representatives
Washington, DC 20515–3001

June 26, 1998

Honorable Richard Riley
Secretary
U.S. Department Of Education
400 Maryland Ave SW
Washington, D.C. 20202-0001

Dear Secretary Riley:

I am writing to offer my opinion about the possible interest rate change for consolidation loans in the Direct Loan program and to urge you to choose the action which gives the lowest possible interest rate.

Under present law, the interest rate for the Direct Loan program's consolidation loans is set in regulation. Currently, Direct Loan consolidation borrowers pay an interest rate of 8.25%. On July 1, the Department will have the authority to drop this rate to 7.46%. Such a change would provide students and their families substantial savings, effectively reducing the cost of higher education. For example, if a student has a $20,000 loan at 8.25%, he or she will pay $2,952 a year for ten years. In contrast, a rate of 7.46% would require payments of $2,832 a year, or a yearly savings of $120. And since consolidations in the Direct Loan program are available to everyone, this change would represent an important savings for a great number of families.

This reduction in borrowing costs is dependent on the Department making a technical change in the regulations outlining the Direct Loan consolidation program. I believe you should take advantage of this opportunity to lower the college costs for all students.

Thank you for your consideration of this matter and your leadership in all higher education issues.

Sincerely,

ROBERT E. ANDREWS
Member of Congress

REA:eh

REPLY TO:

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WASHINGTON, DC 20515–3001
(202) 225-6501

☐ 505 A WHITE HORSE PIKE
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(609) 546-5100

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e-mail at: randrews@hr.house.gov

GOVERNMENT & POLITICS

July 3, 1998

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Education Department Will Cut Interest Rates for Some Refinanced Student Loans

By STEPHEN BURD

WASHINGTON

The Clinton Administration is planning to offer borrowers who want to refinance their student loans in the direct-loan program a great deal -- but perhaps for a limited time only.

In a letter to Congressional leaders in June, Marshall S. Smith, the department's Acting Deputy Director, announced that, beginning July 1, the Administration would slash for three months the interest rate that the government charges borrowers who consolidate their loans into direct lending.

The move, the Education Department said, is meant to allow borrowers who wish to refinance their loans the chance to benefit from the same reduced interest rates that Congress has granted new borrowers.

But the announcement angered Republican lawmakers, who saw the move as an effort to give the direct-loan program dominance in the market for consolidated student loans by offering terms that banks cannot match. They also questioned whether the direct-loan program was ready to handle a new flood of borrowers wishing to consolidate their student loans.

"It doesn't make sense to me why they would want to overload a program that has had such problems," said Rep. Howard P. (Buck) McKeon, the California Republican who heads the House subcommittee in charge of renewing the Higher Education Act.

In a closed-door meeting last week, Mr. McKeon urged department officials to reconsider their decision, warning that proceeding could force lawmakers to shut them out of the final negotiations on a bill to renew the Higher Education Act. As of press time, the department had not backed down, but a spokeswoman there acknowledged that it was in "discussions" with Republican lawmakers over the matter.

In May, lawmakers attached to a transportation bill a provision that would lower the interest rate on new student loans in the guaranteed-loan program by eight-tenths of a percentage point for a three-month period starting July 1. The legislation, which was meant to temporarily avert an impending crisis in the program, was overwhelmingly approved by Congress and signed by the President in June.

Attaching the temporary provision on interest rates was meant to buy lawmakers more time to complete work on legislation to renew the Higher Education Act, which contains a longer-term version of the interest-rate provision that was included in the transportation bill (*The Chronicle,* June 5).

The transportation measure did not set the interest rate for borrowers who wish to refinance their loans during the three months. Consolidation allows students who have loans from more than one lender to combine their debts into one loan, with one monthly payment.

College lobbyists and student advocates have urged the Education Department and lawmakers to lower the rate for individuals consolidating their debts in the loan programs. They have argued that those who seek to ease their debt burden by refinancing their loans should not have to pay higher interest rates than those with new loans.

Mr. Smith wrote to lawmakers that the department would like the temporary reduction in the interest rates for borrowers who consolidate loans in the direct-loan program to be extended to those who do so in the guaranteed-loan program, as well as to be made permanent in the Higher Education Act legislation. But he noted that the department lacked the authority to reduce rates, even temporarily, for those who wished to consolidate their loans in the guaranteed program.

"We know you share our desire to reduce costs as much as possible for borrowers in both programs, and we would like to work with you to enact legislation to improve the terms of the guaranteed-loan program's Consolidation Loans to match the terms of Direct Consolidation Loans as soon as possible," Mr. Smith wrote.

But Republicans said they did not believe that lenders would be able to consolidate loans under those terms. Last year, when Congress approved a bill requiring lenders to reduce their interest rates on consolidated loans by as much as a percentage point, Sallie Mae stopped consolidating loans, saying that doing so was no longer profitable. Before that, Sallie Mae was the top private consolidator of loans.

Republican lawmakers also wondered whether the Education Department was setting up itself -- and loan borrowers -- for disaster. Last August, the department, citing a backlog of more than 80,000 borrowers seeking to refinance their loans into direct lending, was forced to suspend its consolidation program for four months.

Despite assurances by department officials that the program is now running well, Republican lawmakers were skeptical that it could handle a flood of new applicants attracted by the reduced rates.

"If the interest rate on consolidation loans is too low, banks will flee, and the only one left in the program will be the government," said Mr. McKeon. "If the department then is not able to handle the increased load, and the program collapses, I don't see how that will help students."

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Date: 07/03/98
Section: Government & Politics
Page: A23

Consolidation Loan Interest Rates

	Direct Loans	FFEL	FY 1998-03 Cost (OMB)
Before the Emergency Consolidation Act.	Interest rates set in regulation. T-bill + 3.1%, set annually, capped at 8.25%. **A typical borrower paid 8.25%.**	Weighted average of underlying loans rounded up to the nearest whole percent. **A typical borrower paid 9.0%.**	
Today. (Under the Emergency Consolidation Act.)	Interest rates set in regulation. T-bill + 3.1%, set annually, capped at 8.25%. **Borrowers pay 8.25%.**	T-bill + 3.1% set annually, capped at 8.25%. **Borrowers pay 8.25%.**	n/a (in baseline)
July 1-October 1. (Under the 3-month provision in ISTEA.)	Interest rates set in regulation. Estimate assumes T-bill + 2.3%. **Borrowers would pay 7.46%.**	T-bill + 3.1% set annually, capped at 8.25%. **Borrowers would pay 8.25%.**	-$3 million (due to the difference between 10-20-year +1, which was assumed in the baseline for Direct Loans, and T-bill + 2.3%.)
October 1. (If no change in law - Emergency Consolidation Act would expire.)	Interest rates set in regulation. Estimate assumes the 10-20-year bond + 1%. **Borrowers would pay 7.11%**	Weighted average of underlying loans, rounded up to nearest whole percentage. **A typical borrower would pay 9.0%**	n/a (in baseline)
House bill. (Manager's amendment.)	Weighted average of underlying loans rounded up to the nearest 1/8th of 1 percent, capped at 8.25%. **A typical borrower would pay 8.25%.**	Weighted average of underlying loans rounded up to the nearest 1/8th of 1 percent, capped at 8.25%. Annual special allowance set at T-bill + 3.1%. **A typical borrower would pay 8.25%.**	No cost. (CBO estimates that the cost will be $100 million.)
Senate bill.	Interest rates set in regulation. Estimate assumes T-bill + 2.3%. **Borrowers would pay 7.46%.**	Weighted average of underlying loans, rounded up to nearest whole percentage. **A typical borrower would pay 9.0%**	-$34 million (due to the difference between 10-20-year +1, which was assumed in the baseline for Direct Loans, and T-bill + 2.3%.)

Administration HEA proposal.	T-Bill + 2.3%, set annually, capped at 8.25%. **Borrowers would pay 7.46%.**	T-Bill + 2.3%, set annually, capped at 8.25%. **Borrowers would pay 7.46%.**	-$34 million (due to the difference between 10-20-year +1, which was assumed in the baseline for Direct Loans, and T-bill + 2.3%.)

June 8, 1998

Employment & Training Administration
U.S. Department of Labor
200 Constitution Avenue, N.W.
Washington, D.C. 20210
tel: 202/219-6050
fax: 202/219-6827

fax transmittal

for: Cece Rouse, Bob Shireman & Broderick Johnson

fax #: 456-2223 456-2223 456-2604

from: Bill Kamela

date: 6/25/98

re: Ashcroft Amendment

pages 6 **(including this cover sheet)**

NOTES:

Excerpt from Initial Staff Decisions

P36	Level of payments	HR
P37	Local youth activities	HR
P37	Eligibility for services	1) HR 2) Part I, p24, "youth"—HR w/a to change term to "eligible youth"
P38-40	Required elements	1) H(A)—SR 2) H(B)—SR 3) S(b)—HR 4) S(B)—HR w/a to add "as appropriate" 5) H(H)—SR w/a to strike "provide" 6) S(C)—HR w/a to add "as appropriate" 7) S(D)—HR w/a to strike "employment" and insert "occupational" 8) S(E)—HR w/a to read "leadership development opportunities, which may community service and peer-centered activities encouraging responsibility and other positive social behaviors during non-school hours, as appropriate"—LC make grammatical correct 9) S(G)—HR 10) S(H)—HR 11) S(I)—HR 12) H(D)—SR w/a to read "provide comprehensive guidance and counseling, which may include drug and alcohol abuse counseling and referral, as appropriate"
P39	S(2) provides	HR
P40	Additional requirements	SR
P41	(b) authorized services	HR
P42	(c)additional requirements	HR
P44	H(6) volunteers	SR—LC figure out where to put this provision
P44	Priority	HR w/HOLD on 50 percent
P44	H(c) Exception	SR w/a to make 5 percent
P45	Prohibitions	1) S(1)—SR 2) S(2)—HOLD, STW, shop to Ashcroft-- made available "None of the funds ~~awarded~~ under this Act may be ~~used for [for [illegible] to fund~~] awarded ~~[illegible]~~ts under the School to Work Act." 3) S(3)—HR
P46	Linkages	HOLD, MGC drafting

Attachment 10—Dwayne's One-Stop System. Part 4. 6-19-98

HOLD for further discussion.

"None of the funds made available under this Act may be awarded under the School-to-Work Opportunities Act of 1994 (20 U.S.C. 6101 et seq.).

Draft - June 1, 1998

DOL Staff Analysis of the Ashcroft Amendment

Senator Ashcroft's amendment prohibits the use of funds provided under S.1186 to carry out activities authorized under the School-to-Work Act. This prohibition could have several harmful effects:

- First, since there is significant overlap between the activities authorized under S.1186 and under the School-to-Work Act, (e.g. job training, mentoring, and linking academic and occupational learning), read literally, the amendment could prohibit such overlapping activities from being carried out under S.1186 even if there is no connection to the School-to-Work Act programs. While the Departments of Education and Labor would not construe the amendment so broadly, the language would allow legal challenges to such activities.

  This also raises a question regarding the operation of School-to-Work programs after the School-to-Work Act terminates on September 30, 2001. By prohibiting the carrying out of activities "authorized" under the School-to-Work Act, the amendment casts doubts over whether S. 1186 funds could be used to continue to carry out many of the functions of the School-to-Work Act programs after termination of that Act. While the Departments would not construe the prohibition to apply so broadly, and would argue that any prohibition terminates with the School-to-Work Act, the amendment could give rise to legal challenges to efforts to carry out such activities.

- Second, the amendment could eviscerate the operation of current programs under the School-to-Work Opportunities Act. The Act specifically requires States and local communities to coordinate and programs and services funded under other Federal statutes, including JTPA and Vocational Education. In fact, the law allows the Secretaries to waive provisions of JTPA and Perkins to facilitate the use of those resources in implementing School-to-Work programs. Therefore, the School-to-Work Act clearly presumes that JTPA and Perkins resources will be available to provide services within the School-to-Work framework. That is what is happening in the 40 States that currently receive School-to-Work implementation grants. By prohibiting the use of funds under S. 1186 for these purposes, the amendment seriously undermines the ability of the School-to-Work programs to provide the comprehensive assistance needed to effectively serve students.

  There is some ambiguity as to the scope of the prohibition -- that is under what circumstances would a S. 1186 activity be considered to be carried out *under* the School-to-Work Act. For example, there is a question as to whether S. 1186 youth activities could "coordinate" with School-to-Work Act programs or "supplement" such programs without being determined to be carried out "under" these programs. These questions would lead to a significant number of legalistic judgements. However, this prohibition is likely to eliminate any formal linkages between School-to-Work programs and S. 1186.

An example of this integration of funds is the San Diego, California School-to-Work initiative which is integrated with the JTPA summer youth employment and training programs. Forty-five percent of the JTPA summer youth program funds are designated for the School-to-Work initiative -- which serves over 1200 young people a year. The School-to-Work summer program places students in jobs within the career cluster in which the student has demonstrated interest and aptitude. Service providers work directly with the school to identify students who are interested in working during the summer. The career clusters in which the students are placed are identified on the basis of labor market information and PIC analysis.

Another example is the Phipps School-to-Work Partnership in New York City. The Phipps partnership is an in-school pathway to college which is operated in cooperation with the State Universities of New York (SUNY) and New Media Industries. The program is funded by JTPA summer youth funds, Department of Education title I funds, Technology Challenge Grants and Pell grants. School-to-Work Urban/Rural Opportunity Grant funding is being used mainly to tie in all other funding sources.

In terms of assessing actual impact, it should be noted that the School-to-Work Opportunities Act is due to sunset on September 30, 2001. The School-to-Work Opportunities Act was intended to provide seed money to States for a period of five years, with the amounts declining in the final two years of the grant. When the prohibition would take effect – July 1, 1999 – eight States would have completed their Implementation Grants and at least 32 would be in the last two years of funding. (To date, eleven States and the District of Columbia have not yet been awarded Implementation Grants.)

The School-to-Work Act is a system-building effort designed to integrate a variety of resources, including certain resources available under JTPA and Perkins. Over the past several years, we have worked to integrate the tenets of School-to-Work into our other youth programs – summer and year-round youth, Job Corps, and our out-of-school youth pilots which form the basis for the Youth Opportunity Area Initiative.

The attached list provides some examples of projects currently underway in States and local communities nationwide which are jointly funded by School-to-Work and JTPA funds.

S:\OPR\DPLD\WFD\98CONF\ANALYSIS.STW

Draft - June 3, 1998

Examples of Projects Jointly Funded by JTPA and STW

General Connections Between JTPA and STW Systems:

- In the State of Idaho, several Regional STW Facilitators are housed at Private Industry Councils (PIC) which serve as fiscal agents for the STW funds. PIC members are also members of local STW partnerships, and visa versa. In addition, the local STW partnership is actually a subcommittee of the PIC in some areas.

Tutoring and Dropout Prevention etc.:

- In South Bend, Indiana, JTPA and STW funds are combined with State funds to finance the "21st Century Scholars" Program. This is a program that guarantees college funding for economically disadvantaged youth who stay off drugs and maintain a "C" average.

Alternative Secondary School Services:

- The State of Indiana recently issued a Request for Proposals to alternative education providers to develop school-to-work for students in alternative education settings. These grants will be financed by a combination of STW, Perkins and JTPA 8% funds.

- In Worcester County, Maryland, JTPA funds are used to provide an alternative classroom for at-risk students. STW funds are utilized to develop the curriculum used in the classroom.

Summer Employment Opportunities and Work-Based Learning:

- The State of New Jersey uses JTPA funds to pay stipends for students participating in work-based learning through local STW programs in three communities.

- In Indiana, some local schools use JTPA IIB and STW funds for summer programming.

- In Boise, Idaho, the local television station -- KBCI/Channel 2 -- is utilizing JTPA and STW funds, along with their own resources, to host a 8-week STW Academy this summer for in-school and out-of-school youth.

Employment Skill Training:

- In Philadelphia, Pennsylvania, JTPA and STW funds jointly support employment skills training through year-round work-based learning activities which include work-place readiness training and job matching.

Community Service and Leadership Development:

- In the State of New Jersey, JTPA and STW funds are used to finance Youth Corps Programs. These programs target at-risk youth and enhance their value to society by providing a comprehensive program of academic instruction and community service work experience.

- In Philadelphia, Pennsylvania, JTPA and STW funds jointly support year-round service learning development opportunities including Youthworks' Summer Youth Service Corps.

Adult Mentoring:

- In the State of New Jersey, two local STW programs funded work-site mentors with JTPA funds.
- In Worcester County, Maryland, JTPA funds are used to provide case management services (including mentoring) to disadvantaged youth who are participants in high school STW programs.

Follow-up Services:

- In Philadelphia, Pennsylvania, JTPA and STW funds jointly support summer programs for many students after graduation as well as case management follow-up services for special education and pregnant and parenting teens.

Preparation for Postsecondary Education:

- In Philadelphia, Pennsylvania, JTPA and STW funds jointly support summer and school-year programs that prepare at-risk youth for postsecondary education.
- In Kankakee Valley, Indiana, career planners paid for by JTPA 8% funds work with school counselors to assist youth participating in STW programs apply to college and with financial aid planning.

Linkages Between Academic and Occupational Learning:

- In Fort Wayne and Valparaiso, Indiana, Private Industry Councils use a combination of JTPA and STW funds to provide student-focused career information.
- In Philadelphia, Pennsylvania, JTPA and STW funds jointly support connecting activities between academic learning, including work-based learning, job development, placement services, and Stakeholder Partnerships -- industry-based groups that work to align academic instruction with industry standards.

Kildee Mtg   Bachus, Longanecker, Abernathy, Tom Kelly,

PK

- Continues policy bec. ISTEA didn't Δ.

~~Kildee~~ deal w/ McLean:

DL
- 80 bp difference before ... marketing was the difference ... (?)

→ weighted avg

"- whatever you do I'll support you ..."

Barbara
desires - smaller subsidy
- direct lend approach

Deal w/ McLean - don't want a confrontation between DL + FFEL.

~~- CBS, Broderick~~

- BB, Scott Fleming, DAL, Alhow, - Johnson

~~[illegible]~~

- They knew this ad. came up, can't feign surprise.

Brad: Want to have a level playing field,
need Congress's help...

** - Why do you have to do this now??

- 85,000 backlog

- hearing undisclosed args for time

- 2400/week

100% capacity to increase

10,000/week - 2 months

- put in que - oppose of stages...

- Paying Contractor - How much?

- 58 days avg.

$\boxed{\$85/1000}$ - Sec. 458

Long term costs are lower...

→ Last tele mtg - said all was fine...

Handling the Demand for Direct Loan Consolidations

The Department of Education is considering three methods of ensuring that the Direct Loan program has the capacity to process all the loan consolidation requests it receives.

1. Expanding EDS Capacity

- **Current excess capacity.** EDS currently processes 2,400 (non-fast track) consolidations each week, although it estimates that it is now able to process up to 4,000 each week.

- **Expanded capacity to mail applications.** EDS has told us that it has doubled its capacity to mail applications, to 10,000 per week. It has also arranged for contingency phone support. The Department is in the process of making the consolidation application available for download from its web page. EDS has not yet seen an increase in the number of application requests.

- **Expanded pre-certification capacity.** By June 29, EDS will have hired 53 additional employees to process up to 5,000 applications per week through the first stages of the consolidation process (application review, data entry, and request for lender certification).

  EDS will hire and train additional staff to expand capacity for these first stages if, based upon application requests, it believes that it will receive more than 5,000 applications each week. EDS has already contacted local temp agencies and believes that these low-skill positions can be filled and trained in the four weeks that borrowers need to return their applications.

  Typically, only 45 percent of borrowers return their consolidation applications in an average of six weeks. EDS is basing its plans on the assumptions that, in the coming months, 75 percent of borrowers will return their applications in an average of four weeks.

- **Plans to expand post-certification capacity.** Lenders certify loan balances in an average of 21 days. Therefore, as application requests and receipts increase, EDS will have time to hire and train staff for the late stages of the consolidation process (certification review, promissory note processing, funding and booking, and customer service).

  EDS has developed a human resources calender describing the employee hires needed to increase processing capacity to 5,000 applications per week. As described, they have already begun hiring staff for the early stages in the consolidation process. They will hire 56 additional employees by July 13 and 40 more by July 20. In total, they will add 149 employees to their staff of 295.

- **Capacity ceiling.** EDS estimates that it cannot expand its capacity beyond processing 10,000 applications each week without substantial capital investments.

2. Consolidating Direct Loans through Direct Loan Servicing

- The Department has begun discussions with CDSI regarding whether it could process consolidation applications from borrower who hold only direct loans (including consolidated direct loans). The Department estimates that about 1.2 million borrowers in grace or repayment hold only direct loans. CDSI already manages direct loan servicing and the Central Data System, which holds borrower data.

- Because of budget rules, borrowers must request a new loan in order to receive the new, lower interest rate (in order for the increased budget costs not to be scored). However, OGC is examining whether we must receive a new promissory note and disburse a new loan.

3. Alternate Consolidators

- The Department could hire one or more additional contractors to complete some Direct Loan consolidations, performing both loan origination and loan servicing operations. These contractors could include FFEL lenders, guaranty agencies, and financial services firms.

- **Agreement with Guaranty Agencies.** The guaranty agencies may agree to make direct consolidation loans under the emergency condition clause as soon as October 1. These loans would be owned by the government and would share the characteristics of Direct Loans. Guaranty agencies have established financial and data transfer links with the Department.

- **CDSI Subcontractors.** The Department's contract with CDSI to administer the Pell program can be expanded to process any applications related to the Title IV programs. Therefore, we have begun discussion with CDSI about processing new consolidation applications under the Pell contract, most likely through subcontractors.

- **GSA Schedule.** The Department is examining the feasibility of purchasing loan consolidation services off the GSA schedule for providing federal financial services.

- **Traditional contracting.** We cannot obtain assistance through a contract awarded through competitive bidding, a process that requires at least nine to 12 months. However, we are exploring how this step might address our long-term needs.

Next Steps

- By July 1, Department staff will have developed:
  - A communications plan for disseminating whatever decision is reached to borrowers and other stakeholders;
  - A draft letter to direct loan borrowers regarding the lower interest rate available through re-consolidation;
  - Operational requirements and performance standards for CDSI to consolidate the loans of borrowers who hold only direct loans;
  - Operational requirements and performance standards for alternative consolidation contractors, including options to require them to transmit data for CDSI loan servicing and to require them to service the loans themselves; and
  - An understanding of the issues regarding using CSDI subcontractors through the Pell contract and guaranty agencies under emergency conditions.

MdL: "Race for the best research"

- Secy didn't agree to a level playing field (?)

Longo/Wecker: Common interest

- same rate

- paid for (?)

- lender subsidy . .

DL - 7 days - decision . -

- show lead Forda by delaying . .

Loan Consolidation Interest Rates
Draft

1. Something for everyone

- House LC proposal (weighted average for students, 3.1 SAP, no change in 105 bp fee)
- Consolidation incentive/origination rebates OR origination fee cuts on new loans
- Reduce McKeon-Kildee subsidy from 5 years to 3-4 years and use the savings for the consolidation incentive rebates

	Savings if 3-year subsidy	Savings if 4-year subsidy
OMB	$1.051 ~~[illegible]~~ billion	$448 ~~[illegible]~~ million
CBO	$378 ~~[illegible]~~ million	$152 ~~[illegible]~~ million

- Modified Kennedy Market Mechanism amendment
- Senate commitment to take up the HEA bill the week after July 4th recess
- DL interest rate stays at 3.1 until October 1 after which it declines unless HEA is enacted

2. New low rate in both consolidation programs paid for by using some of the McKeon-Kildee subsidy for FFEL loan consolidation

- Consolidation rates at 2.3 in both program for students
- Consolidators get 3.1 SAP; no change in 105 bp fee
- Consolidator SAP is paid for by:
    a. using half of the McKeon-Kildee subsidy (reduces subsidy on new loans from 50 bps to 33 bps -- just above the top of the Treasury range of reasonable returns)
    b. Shortening the duration of McKeon-Kildee subsidy (but this would lead to a higher total level of lender subsidy if it were extended)
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	Savings if 3-year subsidy	Savings if 4-year subsidy
OMB	$1.2 billion	$625 million
CBO	$455 million	$235 million

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- Senate commitment to take up the HEA bill the week after July 4th recess
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- DL interest rate stays at 3.1 until October 1 after which it declines unless HEA is enacted

Loan Consolidation Interest Rates
Draft

as today
consumers

1. Something for everyone

- House LC proposal (weighted average for students, 3.1 SAP, no change in 105 bp fee)

-no rounding, simplify weighting
- Consolidation incentive/origination rebates OR origination fee cuts on new loans
$ or %
- Reduce McKeon-Kildee subsidy from 5 years to 3-4 years and use the savings for the consolidation incentive rebates

	Savings if 3-year subsidy	Savings if 4-year subsidy
OMB	$1.2 billion	$625 million
CBO	$455 million	$235 million

- Modified Kennedy Market Mechanism amendment

? - Senate commitment to take up the HEA bill the week after July 4th recess

loan consolidation
- DL interest rate stays at 3.1 until October 1 after which it declines unless HEA is enacted

- fully financed

2. New low rate in both consolidation programs paid for by using some of the McKeon-Kildee subsidy for FFEL loan consolidation

- Consolidation rates at 2.3 in both program for students
- Consolidators get 3.1 SAP; no change in 105 bp fee
- Consolidator SAP is paid for by:

  a. using half of the McKeon-Kildee subsidy (reduces subsidy on new loans from 50 bps to 33 bps -- just above the top of the Treasury range of reasonable returns)

  OR

  b. Shortening the duration of McKeon-Kildee subsidy (but this would lead to a higher total level of lender subsidy if it were extended)

- DL interest rate stays at 3.1 until October 1 after which it declines unless HEA is enacted
  consol.

- equalizing fees ?

in both DL & FFEL

pledge to ?

In the conference on the reauthorization of the Higher Education ~~Act~~ (H.R. ~~6~~), and in the context of other legislation as applicable, we will ~~work cooperatively~~ to achieve the following shared goals with respect to the student loan programs:

- Provide ~~current borrowers~~ with the opportunity to consolidate their loans at the same low ~~rate~~ as new loans. ~~This will require adjustments~~ to make ~~the rate~~ viable ~~for~~ FFEL lenders. Maintain current lender yield on loan consolidation...

- Equalize benefits in Direct Loans and FFEL by providing for:

  --the same fees to be paid by students in both programs;

  --income-contingent repayment to be made available in FFEL, and to ensure that any amount forgiven (in DL or FFEL) is not subject to taxation.

- Allow for the testing of market-based approaches to setting lender subsidies, consistent with modernization of student aid systems generally. Include a trigger to encourage a future Congress to consider the results.

- Impose no new costs on taxpayers.

Fully finance w/ mutually agreed offsets

reduce to 3 yrs

~~cut off at 3~~

possibly...

→ ... 3.1 ...

UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF THE GENERAL COUNSEL

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MESSAGE:

CONFIDENTIALITY NOTICE

Draft Talking Points for McKeon Meeting
June 23, 1998

(Send the Consolidation Chart and a fact sheet, based on our draft letter, before the meeting so McKeon is knowledgeable about consolidation rates and the background of the decision.)

Administration wants low rate in both programs

- Our HEA proposal had level playing field rates
- No Administration plan to have DL consolidation lower than FFEL consolidation

The current situation is the result of Congress not setting interest rates on FFEL consolidation loans to match the lower interest rate on individual FFEL and Direct loans.

Differentials aside, the dropping of the rate for DL consolidation gives students the benefit they have long expected (at least in one of the programs) and is consistent with Administration Policy

- DL consolidations historically have mirrored the interest rate for individual student loans.
- The dropping of the rate is already reflected in both the CBO and OMB baselines.
- The students are counting on this drop in the interest rate, and we've been saying all along that we support lower interest rate for students.
- In light of all these factors, why should we do something different now that raises interest rates for students?

The Administration has a plan for implementing increased DL consolidation applications and not hurting FFEL during the three month period (if that is the period of the differential)

- We do not intend to try to take away business from FFELP lenders.
- We won't promote DL consolidation; no press releases
- We will say we want to work with Congress for the benefit of everyone.
- We are expanding capacity -- contractors

Our objective is to achieve a long-term solution on this issue that provides lower interest rates for students, reasonable returns for lenders, and a fair break for the taxpayers.

- We've been trying to achieve this objective for months through our reauthorization proposal and our discussions with the Hill.
- We are still willing to try, although time is now short.
- We would like nothing better than to work with you and other key members. But we must do it quickly -- over the next couple of days.
- If you are unwilling to do that, then you are making a conscious decision to

charge higher interest rates on FFELP consolidation loans, and we have no control over that decision.

The Chronicle of Higher Education
Today's News

Tuesday, June 23, 1998

White House Grants Temporary Cut in Interest Rate on Refinanced Student Loans

By STEPHEN BURD

WASHINGTON

The Clinton Administration announced on Friday that it will slash for three months the interest rate that the federal government charges borrowers who want to refinance their student loans into the direct-lending program.

The move, the Education Department said, is meant to allow borrowers who wish to consolidate their student-loan debt the chance to take advantage of the same reduced interest rates that Congress has granted new loan borrowers. But Republican lawmakers and lenders said they see the department's move as an effort to gain dominance over the student-loan-consolidation market by offering terms that banks cannot match. They also question whether the department's direct-loan program is ready to handle a new flood of borrowers wishing to consolidate their student loans.

In May, lawmakers attached to a transportation bill a provision that would lower the interest rate on new student loans, borrowed for three months, starting July 1, by O.8 of a percentage point. The legislation, which was meant to temporarily avert an impending crisis in the guaranteed-student-loan program, was overwhelmingly approved by Congress and signed into law by the President earlier this month.

The decision to attach the temporary provision on interest rates was meant to buy lawmakers more time to complete work on legislation to renew the Higher Education Act, which contains a longer-term version of the compromise on the student-loan interest rate that was included in the transportation bill. (For background, see a story that appeared in *The Chronicle of Higher Education* on June 5.)

The legislation did not set the interest rate for borrowers consolidating their loans during this period of time. Consolidation allows students who have loans from more than one lender to combine their debts into one loan, with one monthly payment.

Students advocates and college lobbyists have urged the Education Department to lower the rate for those consolidating their debts. They have argued that those who seek to ease their debt burden by refinancing their loans should not have to pay higher interest rates than those who take out new loans.

In a letter to Republican Congressional leaders announcing the department's decision, Marshall S. Smith, the department's Acting Deputy Director, said that the department would like the short-term reduction in the interest rates for loan consolidators in the direct-loan program to be extended to the guaranteed-loan program and to be made permanent in the legislation renewing the Higher Education Act. But he noted that the department lacked the authority to reduce rates, even temporarily, for those who wished to consolidate their loans in the guaranteed program.

"We regret that the law does not ensure borrowers consolidating in the guaranteed-loan program receive this same benefit as borrowers consolidating in Direct Loans," Mr. Smith wrote. "We know you share our desire to reduce costs as much as possible for borrowers in both programs, and we would like to work with you to enact legislation to improve the terms of the guaranteed-loan program's Consolidation Loans to match the terms of Direct Consolidation Loans as soon as possible."

But Republican lawmakers said they did not believe that lenders would be able to consolidate loans under these terms. Last year, when Congress approved a bill requiring lenders to reduce their interest rates on consolidated loans by a percentage point, Sallie Mae stopped consolidating loans, stating that they were no longer profitable to make. Before that, Sallie Mae was the top private consolidator.

Republican lawmakers also questioned whether the department wasn't setting itself -- and loan borrowers -- up for disaster. Last August, the department, citing a backlog of more than 80,000 borrowers seeking to consolidate multiple student loans into single direct loans, was forced to suspend its consolidation program for four months.

Despite department assurances that the program is running fine now, aides to Republican lawmakers were skeptical that it could handle a flood of new applicants, excited by the reduced rates.

"This is a bit like a car dealer dropping interest rates on loans for lemons," said Jay Diskey, a spokesman for the House Committee on Education and the Workforce. "Borrowers should beware: This is the same department that left students hanging for months last year."

Background stories from *The Chronicle:*

- "Congress Votes to Delay Change in Formula Used to Calculate Interest Rate on Student Loans," 5/26/98
- "House Votes Down Proposal to Bar Racial Preferences in Admissions," 5/15/98
- "Many Colleges Are Angry at Sallie Mae for Stopping Loan Consolidations,"

12/19/97

- "Education Dept. Resumes Accepting Loan-Consolidation Applications," 12/12/97
- "Lenders Thwarted in Effort to Block Change in Interest Rates on Student Loans," 9/26/97
- "U.S. Stops Program to Refinance Student Loans," 9/12/97

Draft Talking Points for McKeon Meeting
June 18, 1998

(Send the Consolidation Chart and a fact sheet, based on our draft letter, before the meeting so McKeon is knowledgeable about consolidation rates and the background of the decision.)

Administration wants low rate in both programs

- Our HEA proposal had level playing field rates
- No Administration plan to have DL consolidation lower than FFEL consolidation

The current situation is the result of Congress not stopping the establishment of a differential in ISTEA

Differentials aside, the dropping of the rate for DL consolidation gives students the benefit they have long expected, at least in one of the programs

- Of course we are not going to try to reverse that reduction, ~~that decision has been made~~ DL consol. have always mirrored; baselines reflect that; students counting on it.
- The dropping of the rate is already reflected in both the CBO and OMB baselines and reversing it would be perceived as taking away a benefit

The Administration has a plan for implementing increased DL consolidation applications and not hurting FFEL during the three month period (if that is the period of the differential)

- we won't promote DL consolidation; no press releases
- we won't say DL only is available for limited time which would drain loans from FFEL
- we will say we want to work with Congress for the benefit of everyone
- we are expanding capacity -- contractors

Q's
- How do you intend to equalize the rates in FFEL
- Don't you actually have to issue a reg'n to do this; doesn't that demonstrate that this is an action you're taking, not simply allowing the status quo to carry forward?

Robert M. Shireman
06/17/98 07:11:15 PM

Record Type: Record

To: pauline_abernathy @ ed.gov @ inet, Barbara Chow/OMB/EOP

cc:
Subject: McKeon message

I would suggest a briefing as follows:

--We want the same low rate for consolidations in both programs.

--But given that Congress didn't address consolidations in the ISTEA bill, the rate in DL is going to be lower starting July 1. (If questioned: That is because the policy in DL has always been to offer the same rate for DL consolidations as for new loans, and the CBO and OMB baselines assume that rate. The higher education groups have made it clear they expect us *not* to change that policy.)

--This creates a temporary differential with FFEL. That may lead to significant demand and FFEL lenders may feel threatened. In order to keep demand down:

--We will not promote the reduced rate. We will do only the minimal Federal Register notice.

--We will ask Congress to work with us to ensure that the same low rate will be provided in both programs. *If there is an impression that this rate will be generally available for the long term, then there shouldn't be a rush into DL.* So it would be helpful for you to join in that goal (which is different from the House-passed bill).

--At the same time, we will be preparing for some increased demand, and are taking steps to be prepared for that.

--Contractor capacity, short and longer term
--Efforts to inform students who have applied, or are interested in applying, with information about possible delays, etc.
--Other efforts to meet possible demand.

Jon_Oberg @ ed.gov (Jon Oberg)
06/22/98 05:58:55 PM

Record Type: Record

To: See the distribution list at the bottom of this message

cc: See the distribution list at the bottom of this message
Subject: Re[4]: McKeon DL Consolidation Rate Meeting

Glad to play the role. If I were Mr. McKeon, here are some different arguments I might consider using...

1. Congress's not totally foreclosing a July 1 drop in DL cons rates in ISTEA is the result of conviction that the Administration would not try to take the issue out of Congress's hands. The House has already acted. I've spoken to Sen Jeffords. He is in agreement that you should not reduce the rate until Congress has a chance to act. You will get a letter from us tomorrow advising you in the strongest terms not to drop the rates.

2. Not foreclosing a July 1 drop in DL cons rates was an oversight. You will get a letter of intent tomorrow, which we expect you to follow. You should not try to take advantage of such an oversight.

3. I have a letter here from FFEL consolidators stating that there will be no FFEL consolidation industry if you drop the rate. I have another letter signed by _X__ lenders that such a ~~low~~ consolidation rate would make their future participation unlikely. You are playing with the future of 70% of the Stafford loan program. How can you even consider dropping the rate?

4. You are doing students and borrowers a huge disfavor. Nothing but chaos can result from such a decision to drop the rate. Did you learn nothing from the backlog hearings last fall? You will get a letter tomorrow from me asking on behalf of students and borrowers not to put them through this again!

5. By holding out a long range solution rather than taking the right action now, you are trying to play a foolish game of blackmail. You know there are no funds available to provide level playing field in both consolidation programs, therefore this is a cheap political move which will threaten the bipartisan HEA.

6. You are obviously trying to favor DL over FFEL, despite your protestations to the contrary. This is an attempt to ruin FFEL completely. Although we have tried to be bipartisan and let both programs compete, you have not cooperated. If you do not keep the DL rate at 3.1, we will act to set it there legislatively, and will have support from the higher education groups, students, and the public. Your own statements have indicated that DL cannot handle 100% of the loan volume.

______________________ Reply Separator ______________________
Subject: Re[3]: McKeon DL Consolidation Rate Meeting
Author: Pauline Abernathy at WDCB01

- 2 opps to Δ play
- DL consol. historically have mirrored..
- their current policy
- they didn't Δ it...
- The announced policy...
No reason to Δ our policy...
(Why shd we ??)
equalize...

Mr [illegible] before,
we've been threatened before...
- the difference is same as before...
- no big splash... 90 day...

DL: we're prepared; [illegible]
- students have said they want this...
([illegible])

- we wouldn't be following thru if didn't have the student groups

(a) - we don't rule out the possibility that you might come in & solve ~~[illegible]~~ passage...

(b) we don't have a lot of choices... [illegible] for 3 days...

McKeon Press:

Date: 6/22/98 3:25 PM

I actually will not be able to be on tonight's 6 pm conference call for more than 5 minutes but the participants of tomorrow's meeting can all make this time. In particular, the conference call is a chance for OLCA to throw out some of the possible hostile questions that could be asked tomorrow as well as for OGC to provide guidance on what to say about the regs and July 1.

Attached are the latest tps Jon prepared. OGC, pls take another look at them. Thanks.

______________________ Reply Separator ______________________

Subject: Re[2]: McKeon DL Consolidation Rate Meeting
Author: Kristi Kimball at WDCB01
Date: 6/22/98 2:10 PM

Pauline would like to hold a short conference call later today with Bob Shireman, Barbara Chow and ED staff to prepare for the Tues. meeting with McKeon.

For those interested, the call will take place from 6:00 to 6:30pm today. To connect, call 456-6799 (then code 6705). If that line is busy, call 456-6777 (then code 6705). Each line can handle seven calls.

Message Sent To:

David_Longanecker @ ed.gov (David Longanecker)
Phyllis_Jean_Sanders @ ed.gov (Phyllis Jean Sanders)
Scott_Fleming @ ed.gov (Scott Fleming)
Thomas_Kelley @ ed.gov (Thomas Kelley)
Maureen_McLaughlin @ ed.gov (Maureen McLaughlin)
Susan_Frost @ ed.gov (Susan Frost)
Diane_Rogers @ ed.gov (Diane Rogers)
Jean_Veta @ ed.gov (Jean Veta)
Robert M. Shireman/OPD/EOP
Kristi_Kimball @ ed.gov (Kristi Kimball)
Pauline_Abernathy @ ed.gov (Pauline Abernathy)

Message Copied To:

Vicky_Stroud @ ed.gov (Vicky Stroud)
Mike_Smith @ ed.gov (Mike Smith)
Tia_Cosey @ ed.gov (Tia Cosey)
Linda_Anderson @ ed.gov (Linda Anderson)
Taronda_Wallace @ ed.gov (Taronda Wallace)
Patricia_Dorn @ ed.gov (Patricia Dorn)

June 16, 1998 p.m.
Pre-decisional staff draft for deliberative purposes; protected by OGC attorney-client privilege

Dear _____:

I am writing to share with you the Department of Education's plans relating to student loan consolidation interest rates.

As you know, the temporary student loan interest rate provisions contained in the Transportation Equity Act for the 21st Century recently signed into law apply to new Stafford student loans made under the Direct Loan and Federal Family Education Loan (FFEL) programs between July 1 and October 1, 1998, but not to Consolidation Loans made under either program. Thus, the new law does not alter the loan consolidation terms established under the Emergency Student Loan Consolidation Act of 1997 and the Higher Education Act, under which Direct Consolidation Loan interest rates are established by regulation and FFEL Consolidation Loan interest rates are set in statute. At present, the Department's regulations set the Direct Consolidation Loan interest rate at the interest rate for Stafford Loans. The Emergency Student Loan Consolidation Act of 1997 improved the statutory terms of FFEL Consolidation Loans to match the terms of Direct Consolidation Loans through July 1, 1998, but did not provide for the maximum FFEL Consolidation Loan rate to decline on July 1 with the new Stafford Loan interest rate.

Thus, the 1997 Act provided for a differential between Direct and FFEL Consolidation Loan interest rates during the last quarter of this fiscal year. Both the Administration's and CBO's baselines reflect this differential. In both, the Direct Consolidation Loan interest rate drops on July 1 to match the new Stafford Loan rate while the FFEL Consolidation Loan interest rate remains by law at the 91-day Treasury Bill rate plus 3.1 percentage points for the remainder of the fiscal year, after which the FFEL Consolidation Loan rate reverts by law to the weighted average of the underlying loans, rounded up to the nearest whole percentage point.

Accordingly, consistent with these budget baselines and current policy, the interest rate on new Direct Consolidation Loans will drop on July 1 when the Stafford Loan rate drops to the 91-day Treasury Bill rate plus 2.3 percentage points, providing borrowers with an opportunity to consolidate their outstanding loans at the new lower student loan rate. We regret that the law does not ensure borrowers consolidating in FFEL receive this same benefit as borrowers consolidating in Direct Loans, which is why the Administration proposed that the reauthorization of the Higher Education Act level the playing field by also setting the maximum FFEL consolidation rate at the new Stafford loan rate. We know you share our desire to reduce costs as much as possible for borrowers in both programs and would like to work with you to enact legislation to improve the terms of FFEL Consolidation Loans to match the terms of Direct Consolidation Loans as soon as possible, and would be pleased to meet with you to discuss this important issue.

Sincerely,

Draft Talking Points on Loan Consolidation
June 17, 1998

Goal: Determine whether the Congressman will support us in lowering the Direct consolidation rate on July 1 -- and will support the Department if demand temporarily exceeds capacity -- in which case we will immediately send the draft letter to the Committee chairs and ranking members. Ask who he thinks should sign the letter. Encourage him to discuss this with Congressman McKeon. ?

We are prepared to formally send this letter to the Education Committee and lower the Direct consolidation rate on July 1 as planned but we will <u>not do it unless we have your support.</u>

- The highway bill was silent on loan consolidation rates.
- Our plan, reflected in the both OMB and CBO baselines, has always been for direct loan consolidation rates to drop with the new loan rate on July 1.
- We are prepared to follow through with this plan and give former students the opportunity to consolidate at the new low rate but will <u>not do it unless we have your support</u>. Student ~~groups know that we will do it as~~ long ~~as we have unified Democratic~~ support.
- student groups want this...

We know that Republicans will not support this step because:

- **Direct consolidation will be significantly more attractive than FFEL consolidation** because FFEL consolidators will not be willing to lower their rates to match Direct consolidation and will be concerned that the loans they currently hold will be consolidated into Direct Loans. Thus, they will claim in will jeopardize their current portfolios (although there was an 80 bp difference between Direct and FFEL prior to the two-way bill).
- **It ~~will~~ may be difficult for Congress to change the Direct consolidation rate in HEA after it has been lowered.**
- **Lenders will want a level playing field and will ask for additional taxpayer subsidy to match direct lending without reducing their profits.**

The student groups and higher education community are urging us to lower the rate now because they believe if the rate is not lowered now, the HEA will <u>not</u> lower the rates.

- That is why opponents of dropping the rate on July 1 will argue the Department should wait for HEA to pass before acting.

• Also - protect us on 458 etc.

Senate Democratic staff say their bosses will support lowering the rate now since it is consistent with the Senate HEA bill. Under the Senate HEA bill, the Direct Loan rate could drop while the FFEL maximum rate would actually rise.

Because students see acting now as the only way to win a lower rate in the HEA, students are willing to risk that demand for Direct consolidation will temporarily exceed processing capacity this summer while the two loan programs are different and while we are further expanding capacity.

- We do not expect a backlog, but it is impossible to predict demand and capacity while expanded is finite in the short-term. We could at least do 50% more over the summer and we believe we could at least double capacity in the fall. We ~~have~~ developed a plan to inform students of any delay and of their options if they need a consolidation loan more quickly.

- Any backlog that developed would be a policy induced backlog -- not a management-induced backlog such as experienced last year.

- Students (and the higher education community) have said they would stand behind the Department if a backlog were to temporarily develop.

- We would need to be sure Democrats would stand with us as well if it were necessary.

We support lowering the rate in both programs in HEA -- that is what we proposed -- and would be willing to delay lowering the rate on July 1 if before July 1 we could reach an acceptable bipartisan agreement with the Committee that would be enacted for October 1.

Budget Implications: Lowering the rate now does not have a scorable cost because it is already in the baseline.

- However, OMB ~~and CBO~~ assumed that lowering the rate ~~would not~~ lead more borrowers to consolidate, ~~and to the extent~~ it ~~does~~ lead to more consolidations, it would have very ~~significant real~~ costs.

- Furthermore, if the FFEL maximum rate were also lowered in the HEA, lenders would demand additional taxpayer subsidy which would have budget costs *unless they were required to use some of the 50 bp subsidy they receive under the McKeon-Kildee to subsidize loan consolidation. This would have the effect of shifting subsidy from lenders to students at no additional cost to taxpayers.*

For the rate to drop on July 1, we will need to publish a clarification of our regulations by Wednesday July 1 so we will need move on Friday, June 26.

- Mir a iradley...

- [illegible]... 408 cvs.

Pauline Abernathy
Office of the Deputy Secretary
U.S. Department of Education
600 Independence Avenue, SW
Washington, DC 20202-0500
Phone (202) 401-1000
Fax (202) 401-9027

TO: Bob

FAX: 62223

PAGES (including cover page): 3

FROM: **Pauline Abernathy**

RE:

"It's your ass."

Gene's concern:
— "Looks like a [illegible] ..."

Right: can be paid

Gen

- We have no leverage now:
  - 3 ~~[illegible]~~ [illegible] be [illegible] / no HR&A
  - Secure HR&A paid for, no sequester prob in 98-99
- Cal[illegible] gives us leverage:
  - possibly in next 10 days
  - certainly in dev'g our acq. strategy
  - (Doesn't expose us to add'l budget probs?)
- Throwing a wrench in? No, we're leaving the wrench where ...

if take out wrench ....

A[illegible]: [illegible], [illegible] guys +

, no leverage

, we get nothing...

We regret that the law does not ensure borrowers consolidating in FFEL receive this same benefit as borrowers consolidating in Direct Loans, which is why the Administration proposed that the reauthorization of the Higher Education Act level the playing field by also setting the maximum FFEL consolidation rate at the new Stafford loan rate. We know you share our desire ~~for a level playing field~~ and would like to work with you to enact legislation to improve the terms of FFEL Consolidation Loans to match the terms of Direct Consolidation Loans as soon as possible, and would be pleased to meet with you to discuss this important issue.

to reduce interest rates for borrowers in both programs

Sincerely,

- includ in [illegible] [illegible], [illegible]

- It's the right thing to do.

- It may give us state leverage.

June 15, 1998 p.m.
Pre-decisional staff draft for deliberative purposes; protected by OGC attorney-client privilege

Dear _____:

I am writing to share with you the Department of Education's plans relating to student loan consolidation interest rates.

As you know, the temporary student loan interest rate provisions contained in the Transportation Equity Act for the 21st Century recently signed into law apply to new Stafford student loans made under the Direct Loan and Federal Family Education Loan (FFEL) programs between July 1 and October 1, 1998, but not to Consolidation Loans made under either program. Thus, the new law does not alter the loan consolidation terms established under the Emergency Student Loan Consolidation Act of 1997 and the Higher Education Act, under which Direct Consolidation Loan interest rates are established by regulation and FFEL Consolidation Loan interest rates are set in statute. At present, the Department's regulations set the Direct Consolidation Loan interest rate at the interest rate for Stafford Loans. The Emergency Student Loan Consolidation Act of 1997 improved the statutory terms of FFEL Consolidation Loans to match the terms of Direct Consolidation Loans through July 1, 1998, but did not provide for the maximum FFEL Consolidation Loan rate to decline on July 1 with the new Stafford Loan interest rate.

Thus, the 1997 Act provided for a differential between Direct and FFEL Consolidation Loan interest rates during the last quarter of this fiscal year. Both the Administration's and CBO's baselines reflect this differential. In both, the Direct Consolidation Loan interest rate drops on July 1 to match the new Stafford Loan rate while the FFEL Consolidation Loan interest rate remains by law at the 91-day Treasury Bill rate plus 3.1% for the remainder of the fiscal year, after which the FFEL Consolidation Loan rate reverts by law to the weighted average of the underlying loans, rounded up to the nearest whole percentage point.

proper [illegible] [illegible]

Accordingly, consistent with these budget baselines and current policy, the interest rate on new Direct Consolidation Loans will drop on July 1 when the Stafford Loan rate drops to the 91-day Treasury Bill rate plus 2.3%, providing borrowers with an opportunity to consolidate their outstanding loans at the new lower student loan rate. With the ~~average student~~ graduating with ~~federal student~~ loans fr~~om a 4-year college owing about $13,000, we must do~~ everything we can to ~~make college more affordable and reduce students' debt burden. Lowering the~~ inter~~est rate on consolidations loans as well as new loans is~~ one way we can fu~~rther this goal.~~

Loan Consolidation Interest Rates
staff draft June 11, 1998

Principles: Students should have an incentive to consolidate and lenders should receive a reasonable return

Strategy: The higher education community is strongly urging ED to lower DL consolidation rates to the new loan rate beginning July 1, as assumed in our and CBO's budgets and in our regs. This would put the DL consolidation rate 80 bps below the maximum FFEL consolidation rate, placing DL at an advantage and likely leading to a significant increase in demand for DL consolidation. Hill Democrats may be willing to approach Republicans and negotiate for a better deal for students in both programs beginning October 1 in exchange for ED not lowering the DL rate unilaterally on July 1. What we say we will do July 1 if no agreement is reached will significantly affect the chances of reaching an agreement. We have said publicly that we think the terms of FFEL loans should be improved to match the terms of DL consolidation loans.

Option A: If the Hill will not agree to our HEA policy of applying the new loan rate to both DL and FFEL loan consolidation beginning October 1 (which has no cost), then we should at least get Option 1b -- weighted average for loan consolidation plus a significant reduction in origination fees plus pay guaranty agencies a fee from the reserves to encourage consolidation of multi-lender accounts. Rationale: this would give students a significant benefit and increase access (benefits current and future students rather than former students), level the playing field between DL and FFEL since some GAs are currently waiving the 1% origination fee, provide a targeted incentive to consolidate multi-lender accounts, and it has a fixed, lower cost.

1b. Same as 1a plus origination fees are reduced/eliminated plus pay guaranty agencies fee from reserves to encourage consolidation of multi-lender accounts

<u>Pros</u>:

- Current students benefit more and former students benefit less.
- Over time the consolidation rate will drop as more new loans are outstanding
- Origination fee changes save students $2.4 billion over 5 years if origination fees are eliminated as in our HEA proposal, $1.7 billion if the first 1% (incl. GA insurance premium) is eliminated for all borrowers, and $880 million if the Harkin amendment were adopted
- Encourages consolidation of loans where the benefits to borrowers and lenders are greatest

<u>Cons</u>:

- Same as for 1a, but also costs the budget $1.4 billion over 5 years if origination fees are eliminated as in our HEA proposal, $700 million if the first 1% is eliminated for all borrowers, and the Harkin amendment costs $880 million and SAVES $100 million with Harkin's offset (CBO scores it as costing $200 million).

Overview of Options:

1. Lower the DL consolidate rate to T-bill +2.3% *on July 1* ($54 m savings scored)
   Plan to manage demand for direct loan consolidation

Options where borrowers pay weighted average:

1a. Borrowers pay weighted average (similar to House bill) ($269 m savings scored)

1b. Borrowers pay weighted average plus origination fees are reduced/eliminated plus pay guaranty agencies fee from reserves to encourage consolidation of multi-lender accounts (Depending on the origination fee provision, could have net savings of $369 million, or net cost of $400 m, or net cost of $1.1 billion)

Options where borrowers pay new loan rate:

2. Lenders get new loan rate and continue to pay the fee ($50 m savings scored; maximum real cost of $1.2 b)

3a. Lenders get the McKeon-Kildee rate SAP ($725 m cost scored; maximum real cost of $4.3 b)

3b. Lenders get the same rate for consolidations as for new loans but still pay a fee (3a plus cut the 105 basis point fee by 30 basis points) ($1.0 b cost scored; maximum real cost of $4.9 b)

3c. Lenders take only a 30 bp cut on outstanding loans that are consolidated (3a plus eliminate the 105 basis point fee) ($1.7 b cost scored; maximum real cost of $5.7 b)

3d. Protect lenders' current excessive returns on outstanding loans (provide a T-Bill+3.1% SAP (80 bp SAP), and eliminate the 105 basis point fee) ($2.2 b cost scored; maximum real cost of $7.6 b)

1. **Lower the DL consolidate rate to T-bill +2.3% on July 1**

Pros:

- Dramatically increases the chance that the rates will be lowered for both programs October 1 since Congress will be reluctant to raise rates for students
- No cost -- even produces small scorable savings although could lead to higher real costs if many more students consolidate
- Will receive strong support from students and the higher education community
- Is consistent with our current policy and our HEA proposal.

Cons:

- May anger Republicans who will claim it tilts the playing field between the two programs but we would have already given them a chance to negotiate a level playing field before acting
- Will need to clarify our regulation to make clear this was always our intention
- Will likely create more demand for DL consolidation than can be processed during the next three months
- May have a negative impact on the FFEL industry, although an 80 bp gap between the two programs existed prior to enactment of the two-way consolidation act last fall.

Plan to manage excess demand if rate is lowered on July 1:
Announce that we will guarantee the new low rate to all direct loan consolidation applications pending or received after the date of announcement. Between July 1 and October 1, we will increase capacity 50% and capacity will be doubled in the fall *[precise numbers and plan to come from SFA]*. If more applications are received than can be processed promptly, borrowers will be notified of the delay and of their options to consolidate with a FFEL consolidator if they need a consolidation loan more quickly. Notifications to this effect would also be included in the application packets sent to borrowers who request an application. The Department would not proactively take steps to increase demand during this three-month period.

1a. **Borrowers pay weighted average**
(Lenders get new loan rate and continue to pay the 105 basis point fee)

Pros:

- Saves $269 million
- Over time the rate will drop as more new loans are outstanding

Cons:

- Does not give students with outstanding loans the benefit of the new low rate, costing students $__ over 5 years compared to lowering the rate in both programs based on our budget assumptions, and up to $__ over 5 years based on an assumption that all students would have consolidated or reconsolidated at the new loan rate.
- Is not consistent with our current policy or our HEA proposal.
- Weighted average is more difficult to implement from a systems perspective.

1b. Same as 1a plus origination fees are reduced/eliminated plus pay guaranty agencies fee from reserves to encourage consolidation of multi-lender accounts

Pros:

- Current students benefit more and former students benefit less.
- Over time the consolidation rate will drop as more new loans are outstanding
- Origination fee changes save students $2.4 billion over 5 years if origination fees are eliminated as in our HEA proposal, $1.7 billion if the first 1% (incl. GA insurance premium) is eliminated for all borrowers, and $880 million if the Harkin amendment were adopted
- Encourages consolidation of loans where the benefits to borrowers and lenders are greatest

Cons:

- Same as for 1a, but also costs the budget $1.1 billion over 5 years if origination fees are eliminated as in our HEA proposal, $400 million if the first 1% is eliminated for all borrowers, and SAVES $400 million with Harkin's offset (CBO currently scores Harkin as costing $200 million).

2. Borrowers in both programs pay new loan rate beginning October 1

Pros:

- Students win, saving students between $700 million-$5.6 billion over 5 years compared to current law (depending on whether more consolidate) and $___ over 5 years compared to House HEA bill
- Scorable savings of $50 million over 5 years if decision to consolidate is left up to borrowers and assuming no change in behavior. Maximum real cost of $1.2 billion.

Cons:

- FFEL consolidators would not find it profitable, leading to FFELs being consolidated into DLs.
- DL would do most consolidation which would require a dramatic increase in DL consolidation capacity.
- Possible long-range increase in costs if market perceives the government as willing to make direct or indirect changes to the economics of outstanding loans.

3a. Borrowers pay new loan rate plus FFEL consolidators get McKeon-Kildee rate SAP (FFEL consolidators are provided the same 50 bp subsidy provided for new loans under the McKeon-Kildee proposal but still pay the 105 basis point fee)

Pros:

- Students win, saving students between $700 million-$5.6 billion over 5 years compared to current law (depending on whether more consolidate) and $___ over 5 years compared to House HEA bill

Cons:

- FFEL lenders still reluctant to consolidate because of 105 bp annual fee on consolidations

- Scorable cost of $725 million if the decision to consolidate is left up to the borrower. Could have up to a $4.3 billion cost if all outstanding loans were consolidated or reconsolidated at the lower rate ($__in FFEL and $__ in DL). The likely cost is MUCH less (*Budget Service to develop a more likely estimate based on years left in repayment and loan balance)*
- Possible long-range increase in costs if market perceives the government as willing to make direct or indirect changes to the economics of outstanding loans.

3b. Borrowers pay new loan rate and FFEL consolidators would get the same for consolidations as for new loans but still pay a fee (3a plus cut the 105 basis point fee by 30 basis points)

<u>Pros</u>:
- Students win

<u>Cons</u>:
- FFEL consolidators will still protest since they may need to consolidate FFEL loans and pay the fee in order to keep some borrowers from consolidating into DL
- Scorable cost of $1 billion if the decision to consolidate is left up to the borrower. Could have up to a $4.9 billion cost if all outstanding loans were consolidated or reconsolidated at the lower rate ($__in FFEL and $__ in DL). The likely cost is MUCH less (*Budget Service to develop a more likely estimate based on years left in repayment and loan balance)*
- Possible long-range increase in costs if market perceives the government as willing to make direct or indirect changes to the economics of outstanding loans

3c. Borrowers pay new loan rate and lenders take a 30 bp cut on outstanding loans that are consolidated (Same as 3a and also <u>eliminate</u> the 105 basis point fee)

<u>Pros</u>:
- Students win
- FFEL lenders less disadvantaged (only 30 bps) compared to current rate on outstanding loans

<u>Cons</u>:
- Scorable cost of $1.7 billion if the decision to consolidate is left up to the borrower. Could have up to a $5.7 billion cost if all outstanding loans were consolidated or reconsolidated at the lower rate ($__in FFEL and $__ in DL). The likely cost is MUCH less (*Budget Service to develop a more likely estimate based on years left in repayment and loan balance)*
- Possible long-range increase in costs if market perceives the government as willing to make direct or indirect changes to the economics of outstanding loans

3d. **Borrowers pay new loan rate and protect FFEL lenders' current excessive returns on outstanding loans** (Borrowers pay new loan rate, and FFEL consolidators are provided a T-Bill+3.1% SAP (80 bp SAP), and eliminate the 105 basis point fee)

<u>Pros</u>:

- Students win
- FFEL lenders would want to consolidate all multiple-lender loans (a minority of all loans) because lenders would not get any lower interest rate or pay a fee and would get the benefit of consolidation if they don't currently hold all of a borrower's loans (higher return for the same fixed servicing cost)

<u>Cons</u>:

- Excessive benefit to FFEL lenders?
- Scorable cost of $2.2 billion if the decision to consolidate is left up to the borrower. Could have up to a $7.6 billion cost if all outstanding loans were consolidated or reconsolidated at the lower rate ($__in FFEL and $__ in DL). The likely cost is MUCH less (*Budget Service to develop a more likely estimate based on years left in repayment and loan balance).*

June 13, 1998

MEMORANDUM FOR GENE SPERLING

FROM: Bob Shireman

SUBJECT: Decision on Interest Rate for Consolidation in Direct Lending

The student loan working group[1] met today and we reached a tentative decision that the Secretary should set the rate for consolidating into direct lending (DL) at the *lowest* level (T-bill plus 2.3 percentage points) starting on July 1. That is 80 basis points less than the maximum rate in the guarantee (FFEL) program. On Monday we will review a draft letter to the congressional committees informing them of the plan and of our desire to work with them in the reauthorization to provide for the same low rate in both DL and FFEL (though lenders could theoretically offer the low rate, it would be unquestionably unprofitable). We will then set up Hill briefings with Democrats, probably Tuesday morning. If that goes smoothly, Republicans will be informed and the letter will be sent.

You will recall some history on the issue of DL consolidation loans:

- After DL was expanded in the 1993 budget deal, the Administration considered an advertising campaign to encourage current FFEL borrowers to consolidate into DL to get a lower interest rate or improved repayment options. After considerable pressure from the industry and Congress, the advertising plans were scrapped.

- Last year, the Education Department got a black eye when its new contractor, EDS, needed to stop taking new applications because of a large backlog and numerous errors in processing. We took a beating in Congress and in the media. Congress passed a one-year "emergency" measure in the fall equalizing interest rates and benefits on FFEL consolidation loans with DL so that FFEL lenders could relieve the pressure. Sallie Mae-- at the time the largest FFEL consolidator -- pulled out because it said the new rate (combined with a fee lenders must pay the government) made the loans unprofitable. EDS has addressed the backlog and the problems that led to it

The issue:

This issue arises because the ISTEA bill -- which fixed the interest rate problem for three months -- was *silent* on what the rate should be for consolidated loans. While *new* loans will have a repayment rate of T-bill plus 2.3 percentage points starting on July 1, under current law the rate for *FFEL consolidations* will remain at T-bill plus *3.1*. The *DL* rate, however, is set by the Secretary, and has always been equal to the rate on new loans, which under the ISTEA bill will be

[1] In addition to me, that's OMB (Barbara Chow, Barry White, Kathy Stack), Treasury (Jon Gruber and others), and Education (Mike Smith, Pauline Abernathy, David Longanecker and others)

T-bill plus 2.3 starting July 1 -- 80 basis points lower than FFEL.

There are a number of potential problems in moving to the low rate:

- Given that the low rate is available only in DL, and possibly only during the three-month window (after that is uncertain, depending on congressional action), there could be a flood of applicants, bringing back the stories of last year's embarrassing backlogs and errors in the consolidation process
- Republicans will kick and scream, hurl accusations, and allege takeover conspiracies. They may have some Democratic allies.
- To match the low rate in FFEL, Republicans would have to find additional offsets, raising the possibility that the budget problems with the bill could get worse.

However, there are strong reasons to offer the lower rate:

- It helps former borrowers reduce their debt burden.
- The student groups, direct loan advocates, and at least some of the college associations are pressing hard for it. (The student groups have promised to publicly heap adulation on us).
- It is the best interpretation of congressional intent (In addition, it comports with CBO's interpretation of current law, as reflected in cost estimates).
- By forcing this issue to be addressed by Congress, it provides leverage that may help us address the excess lender subsidies and perhaps other issues in the HEA reauthorization.
- This is the best way to get a low consolidation rate for the long term, in both programs since it will be difficult for Congress to increase it once it is set. (Though we don't think that it would be as stuck downward as the rate on new loans)

The other option would be to leave the rate at T-bill plus 3.1. That would bring us scorn from the student groups but praise from no one. Overall it is the safer route, but it gains us nothing. Ultimately, the consensus was that the certain and potential benefits of moving to the low rate are worth the risks.

To reduce those risks, I have already received pledges from the student groups that if we adopt the low rate, and if that causes backlogs in the system and/or cause Republicans to retaliate, they will *aggressively* defend the Administration. We will ask the key Democrats for the same. Meanwhile, Education and EDS have prepared plans to handle increased demand over the short and long term

*

ED, OMB, Treas, etc.

Consolidation

6/12/98

p. 6 @ 23 – std

* – FFEL could be lowered @ no cost

→ work something out – if so, 3.1

– weighted avg + ang. fee ?

– cost consolidation – ~~multi-lender~~

→ incentive to consolidate... increase to lenders w/o cost...

House: weighted avg w/ 3.1 SAP

→ add student incentive...
$150 to consolidate the loan → they pay fee..

2.3

– leverage
• better for students
– pressure on subsidy

– lacks low rate → pay-for from elsewhere.

2.3 * Most leverage
– most potential expense – but access to students..

(bill: 458)

- R. 3 Center → Monday

- ak ngeplen . .

→ Tuesday args on Holl . . .

Pauline Abernathy
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Phone (202) 401-1000
Fax (202) 401-9027

-impulse is appealing. -
[illegible] should [illegible]
consequence [illegible]
-accountability
mech...

TO: Bob S

FAX: x62223

PAGES (including cover page): ~~4~~ 6

FROM: **Pauline Abernathy**

RE: ~~LC $~~ Write up ~~[illegible]~~

Loan Consolidation Interest Rates
staff draft June 11, 1998

Principles: Students should have an incentive to consolidate and lenders should receive a reasonable return

Strategy: The higher education community is strongly urging ED to lower DL consolidation rates to the new loan rate beginning July 1, as assumed in our and CBO's budgets and in our regs. This would put the DL consolidation rate 80 bps below the maximum FFEL consolidation rate, placing DL at an advantage and likely leading to a significant increase in demand for DL consolidation. Hill Democrats may be willing to approach Republicans and negotiate for a better deal for students in both programs beginning October 1 in exchange for ED not lowering the DL rate unilaterally on July 1. What we say we will do July 1 if no agreement is reached will significantly affect the chances of reaching an agreement. We have said publicly that we think the terms of FFEL loans should be improved to match the terms of DL consolidation loans.

How does what follows achieve this?

Option A: If the Hill will not agree to our HEA policy of applying the new loan rate to both DL and FFEL loan consolidation beginning October 1 (which has no cost), then we should at least get weighted average for loan consolidation plus a significant reduction in origination fees plus pay guaranty agencies a fee from the reserves to encourage consolidation of multi-lender accounts. Rationale: this would give students a significant benefit and increase access (benefits current and future students rather than former students), level the playing field between DL and FFEL since some GAs are currently waiving the 1% origination fee, provide a targeted incentive to consolidate multi-lender accounts, and it has a fixed, lower cost.

Overview of Options:

1. Lower the DL consolidate rate to T-bill +2.3% *on July 1* ($54 m savings scored)
   Plan to manage demand for direct loan consolidation

<u>Options where borrowers pay weighted average:</u>

1a. Borrowers pay weighted average (similar to House bill) ($269 m savings scored)

1b. Borrowers pay weighted average plus origination fees are reduced/eliminated plus pay guaranty agencies fee from reserves to encourage consolidation of multi-lender accounts (Net savings of $369 million, or net cost of $400 m, or net cost of $1.1 billion)

<u>Options where borrowers pay new loan rate:</u>

2. Lenders get new loan rate and continue to pay the fee ($50 m savings scored; maximum real cost of $1.2 b)

3a. Lenders get the McKeon-Kildee rate SAP ($725 m cost scored; maximum real cost of $4.3 b)

3b. Lenders get the same rate for consolidations as for new loans but still pay a fee (3a plus cut the 105 basis point fee by 30 basis points) ($1.0 b cost scored; maximum real cost of $4.9 b)

3c. Lenders take only a 30 bp cut on outstanding loans that are consolidated (3a plus <u>eliminate</u> the 105 basis point fee) ($1.7 b cost scored; maximum real cost of $5.7 b)

3d. Protect lenders' current excessive returns on outstanding loans (provide a T-Bill+3.1% SAP (80 bp SAP), and <u>eliminate</u> the 105 basis point fee) ($2.2 b cost scored; maximum real cost of $7.6 b)

1. Lower the DL consolidate rate to T-bill +2.3% on July 1

Pros:

- Dramatically increases the chance that the rates will be lowered for both programs October 1 since Congress will be reluctant to raise rates for students
- No cost -- even produces small scorable savings although could lead to higher real costs if many more students consolidate
- Will receive strong support from students and the higher education community
- Is consistent with our current policy and our HEA proposal.

Cons:

- May anger Republicans who will claim it tilts the playing field between the two programs but we would have already given them a chance to negotiate a level playing field before acting
- Will need to clarify our regulation to make clear this was always our intention
- Will likely create more demand for DL consolidation than can be processed during the next three months
- May have a negative impact on the FFEL industry, although an 80 bp gap between the two programs existed prior to enactment of the two-way consolidation act last fall.

Plan to manage excess demand if rate is lowered on July 1:
Announce that we will guarantee the new low rate to all direct loan consolidation applications pending or received after the date of announcement. Between July 1 and October 1, we will increase capacity 50% and capacity will be doubled in the fall *[precise numbers and plan to come from SFA]*. If more applications are received than can be processed promptly, borrowers will be notified of the delay and of their options to consolidate with a FFEL consolidator if they need a consolidation loan more quickly. Notifications to this effect would also be included in the application packets sent to borrowers who request an application. The Department would not proactively take steps to increase demand during this three-month period.

1a. Borrowers pay weighted average
(Lenders get new loan rate and continue to pay the 105 basis point fee)

Pros:

- Saves $269 million
- Over time the rate will drop as more new loans are outstanding

Cons:

- Does not give students with outstanding loans the benefit of the new low rate, costing students $__ over 5 years compared to lowering the rate in both programs based on our budget assumptions, and up to $__ over 5 years based on an assumption that all students would have consolidated or reconsolidated at the new loan rate.
- Is not consistent with our current policy or our HEA proposal.
- Weighted average is more difficult to implement from a systems perspective.

1b. Same as 1a plus origination fees are reduced/eliminated plus pay guaranty agencies fee from reserves to encourage consolidation of multi-lender accounts

Pros:
- Current students benefit more and former students benefit less.
- Over time the consolidation rate will drop as more new loans are outstanding
- Origination fee changes save students $2.4 billion over 5 years if origination fees are eliminated as in our HEA proposal, $1.7 billion if the first 1% (incl. GA insurance premium) is eliminated for all borrowers, and $880 million if the Harkin amendment were adopted
- Encourages consolidation of loans where the benefits to borrowers and lenders are greatest

Cons:
- Same as for 1a, but also costs the budget $1.4 billion over 5 years if origination fees are eliminated as in our HEA proposal, $700 million if the first 1% is eliminated for all borrowers, and the Harkin amendment costs $880 million and SAVES $100 million with Harkin's offset (CBO scores it as costing $200 million).

2. Borrowers in both programs pay new loan rate beginning October 1

Pros:
- Students win, saving students between $700 million-$5.6 billion over 5 years compared to current law (depending on whether more consolidate) and $___ over 5 years compared to House HEA bill
- Scorable savings of $50 million over 5 years if decision to consolidate is left up to borrowers and assuming no change in behavior. Maximum real cost of $1.2 billion.

Cons:
- FFEL consolidators would not find it profitable, leading to FFELs being consolidated into DLs.
- DL would do most consolidation which would require a dramatic increase in DL consolidation capacity.
- Possible long-range increase in costs if market perceives the government as willing to make direct or indirect changes to the economics of outstanding loans.

3a. Borrowers pay new loan rate plus FFEL consolidators get McKeon-Kildee rate SAP (FFEL consolidators are provided the same 50 bp subsidy provided for new loans under the McKeon-Kildee proposal but still pay the 105 basis point fee)

Pros:
- Students win, saving students between $700 million-$5.6 billion over 5 years compared to current law (depending on whether more consolidate) and $___ over 5 years compared to House HEA bill

Cons:
- FFEL lenders still reluctant to consolidate because of 105 bp annual fee on consolidations

- Scorable cost of $725 million if the decision to consolidate is left up to the borrower. Could have up to a $4.3 billion cost if all outstanding loans were consolidated or reconsolidated at the lower rate ($__in FFEL and $__ in DL). The likely cost is MUCH less *(Budget Service to develop a more likely estimate based on years left in repayment and loan balance)*
- Possible long-range increase in costs if market perceives the government as willing to make direct or indirect changes to the economics of outstanding loans.

3b. Borrowers pay new loan rate and FFEL consolidators would get the same for consolidations as for new loans but still pay a fee (3a plus cut the 105 basis point fee by 30 basis points)

Pros:

- Students win

Cons:

- FFEL consolidators will still protest since they may need to consolidate FFEL loans and pay the fee in order to keep some borrowers from consolidating into DL
- Scorable cost of $1 billion if the decision to consolidate is left up to the borrower. Could have up to a $4.9 billion cost if all outstanding loans were consolidated or reconsolidated at the lower rate ($__in FFEL and $__ in DL). The likely cost is MUCH less *(Budget Service to develop a more likely estimate based on years left in repayment and loan balance)*
- Possible long-range increase in costs if market perceives the government as willing to make direct or indirect changes to the economics of outstanding loans

3c. Borrowers pay new loan rate and lenders take a 30 bp cut on outstanding loans that are consolidated (Same as 3a and also eliminate the 105 basis point fee)

Pros:

- Students win
- FFEL lenders less disadvantaged (only 30 bps) compared to current rate on outstanding loans

Cons:

- Scorable cost of $1.7 billion if the decision to consolidate is left up to the borrower. Could have up to a $5.7 billion cost if all outstanding loans were consolidated or reconsolidated at the lower rate ($__in FFEL and $__ in DL). The likely cost is MUCH less *(Budget Service to develop a more likely estimate based on years left in repayment and loan balance)*
- Possible long-range increase in costs if market perceives the government as willing to make direct or indirect changes to the economics of outstanding loans

3d. Borrowers pay new loan rate and protect FFEL lenders' current excessive returns on outstanding loans (Borrowers pay new loan rate, and FFEL consolidators are provided a T-Bill+3.1% SAP (80 bp SAP), and eliminate the 105 basis point fee)

Pros:

- Students win
- FFEL lenders would want to consolidate all multiple-lender loans (a minority of all loans) because lenders would not get any lower interest rate or pay a fee and would get the benefit of consolidation if they don't currently hold all of a borrower's loans (higher return for the same fixed servicing cost)

Cons:

- Excessive benefit to FFEL lenders?
- Scorable cost of $2.2 billion if the decision to consolidate is left up to the borrower. Could have up to a $7.6 billion cost if all outstanding loans were consolidated or reconsolidated at the lower rate ($__in FFEL and $__ in DL) The likely cost is MUCH less *(Budget Service to develop a more likely estimate based on years left in repayment and loan balance).*

Consolidation Loan Options
(In millions of dollars)

Baseline:
FFEL -- Weighted average rounded up to the whole percent.
Direct Loans -- 10-20 Year Bond plus 1 percent.

Options:
Budget Forecast: Consolidation policy will not induce borrowers to consolidate.

100% Consolidation: All consolidators in the Budget Forecast plus 100 % inducement of current consolidators to reconsolidate.

100% Students: All consolidators in the Budget Forecast plus 100% inducement of all outstanding student loans to consolidate.

July Option 1

Student rate:	T+3.1 for 3 months, T+2.3 for 5 years
Lender rate:	T+3.1 for 3 months, T+2.3 for 5 years
Consol. Holder fee:	105 bp

Amount of Consolidation	Budget Cost	Student Savings
Budget forecast	-576	-$710

July Option 2

Student rate:	T+2.3 -- 98-03
Lender rate:	T+2.3 -- 98-03
Consol. Holder fee:	105 bp

Amount of Consolidation	Budget Cost	Student Savings
Budget forecast	-54	-741

October Option 1a

Student rate:	Weighted Average
Lender rate:	Weighted Average
Consol. Holder fee:	105 bp

Amount of Consolidation	Budget Cost	Student Savings
Budget forecast	-269	
100% Consolidations	-241	
100% Students	-241	

100% reconsolidations

Being calculated

October Option 1b

Student rate:	Weighted Average
Lender rate:	Weighted Average
Consol. Holder fee:	75 bp

Amount of Consolidation	Budget Cost	Student Savings
Budget forecast	23	
100% Consolidations	169	
100% Students	169	

October Option 1c

Student rate:	Weighted Average
Lender rate:	Weighted Average
Consol. Holder fee:	0 fee

Amount of Consolidation	Budget Cost	Student Savings
Budget forecast	752	
100% Consolidations	1,193	
100% Students	1,193	

October Option 1d

Student rate:	Weighted Average - 20 bp
Lender rate:	Weighted Average
Consol. Holder fee:	105 bp

Amount of Consolidation	Budget Cost	Student Savings
Budget forecast	379	
100% Consolidations	568	
100% Students	1,624	

October Option 1e

Student rate:	Weighted Average - 20 bp
Lender rate:	Weighted Average
Consol. Holder fee:	0 fee

Amount of Consolidation	Budget Cost	Student Savings
Budget forecast	1,401	
100% Consolidations	2,002	
100% Students	3,058	

October Option 1f

Student rate:	Weighted Average - 20 bp
Lender rate:	T+3.1
Consol. Holder fee:	0 fee

Amount of Consolidation	Budget Cost	Student Savings
Budget forecast	1,535	
100% Consolidations	2,122	
100% Students	3,178	

October Option 2

Student rate:	T+2.3
Lender rate:	T+2.3
Consol. Holder fee:	105 bp

Amount of Consolidation	Budget Cost	Student Savings
Budget forecast	-50	-704
100% Consolidations	79	-1,651
100% Students	1,206	-5,609

October Option 3a

Student rate:	T+2.3
Lender rate:	T+2.8
Consol. Holder fee:	105 bp

Amount of Consolidation	Budget Cost	Student Savings	Budget Cost DL	Budget Cost FFEL
Budget forecast	725	-704		
100% Consolidations	1,268	-1,651		
100% Students	4,300	-5,609	1217	3083

October Option 3b

Student rate:	T+2.3
Lender rate:	T+2.8
Consol. Holder fee:	75bp

Amount of Consolidation	Budget Cost	Student Savings	Budget Cost DL	Budget Cost FFEL
Budget forecast	1,017	-704		
100% Consolidations	1,901	-1,651		
100% Students	4,933	-5,609	1261	3672

October Option 3c

Student rate:	T+2.3
Lender rate:	T+2.8
Consol. Holder fee:	0bp

Amount of Consolidation	Budget Cost	Student Savings	Budget Cost DL	Budget Cost FFEL
Budget forecast	1,747	-704		
100% Consolidations	2,703	-1,651		
100% Students	5,735	-5,609	1261	4474

October Option 3d

Student rate:	T+2.3
Lender rate:	T+3.1
Consol. Holder fee:	0bp

Amount of Consolidation	Budget Cost	Student Savings	Budget Cost DL	Budget Cost FFEL
Budget forecast	2,210	99		
100% Consolidations	3,417	-363		
100% Students	7,607	-363	1261	6346

October Option 4a

Student rate:	T+2.3
Lender rate:	T+3.1
Consol. Holder fee:	0bp

Amount of Consolidation	Budget Cost	Student Savings	Budget Cost DL	Budget Cost FFEL
Budget forecast	0	0		
100% Consolidations	0	149		
100% Students	0	149	0	0

The 100% Students amounts do not include increased reciepts to the Consolidated Loan Holder fee if students were required to consolidate to take advantage of the lower rate.

Assume existing loans consolidate upon entering repayment.

~~June 9, 1998~~ 6/10/98
Budget Service

Pauline Abernathy
Office of the Deputy Secretary
U.S. Department of Education
600 Independence Avenue, SW
Washington, DC 20202-0500
Phone (202) 401-1000
Fax (202) 401-9027

TO: Bob S

FAX: x62223

PAGES (including cover page): 4

FROM: **Pauline Abernathy**

RE: LC $ - write up to come.

Issue: Consol. rate on July / Oct

[– Is Cong'l intent clear?]

Loan Consolidation Interest Rates
staff draft June 9, 1998

= low rate

Principles: Students should have an incentive to consolidate and lenders should receive a reasonable return

Goal: Our HEA policy: apply the new loan rate to both DL and FFEL loan consolidation beginning October 1 – but is it viable ??

Strategy: The higher education community is strongly urging ED to lower DL consolidation rates to the new loan rate beginning July 1, as assumed in our and CBO's budgets and in our regs. This would put the DL consolidation rate 80 bps below the maximum FFEL consolidation rate, placing DL at an advantage and likely leading to a significant increase in demand for DL consolidation. Hill Democrats may be willing to approach Republicans and negotiate for lower rates in both programs beginning October 1 in exchange for ED not lowering the DL rate unilaterally on July 1. What we say we will do July 1 if no agreement is reached will significantly affect the chances of reaching an agreement. We have said publicly that we think the terms of FFEL loans should be improved to match the terms of DL consolidation loans.

Overview of Options:

I. July 1 Options If No Agreement Is Reached to Lower the Rate in Both Programs on Oct. 1:

1. Lower the DL consolidate rate to T-bill +2.3% on July 1
   Plan to manage demand for direct loan consolidation
2. Keep the DL consolidation rate at T-bill +3.1% on July 1 and state our intention to lower the rate as planned on October 1

II. Options for a Negotiated Agreement for Oct. 1 (assume the same rate in both programs):

1a. Borrowers pay weighted average (similar to House HEA bill)
1b. Borrowers pay weighted average plus origination fees are reduced/eliminated
1c. 1a or 1b plus pay guaranty agencies fee from reserves to encourage consolidation of multi-lender accounts
2. Borrowers pay new loan rate
3a. Borrowers pay new loan rate plus FFEL consolidators get the McKeon-Kildee rate
3b. Borrowers pay new loan rate and FFEL consolidators would get the same for consolidations as for new loans and still pay a fee (3a plus cut the 105 basis point fee by 30 basis points)
3c. Borrowers pay new loan rate and lenders take a 30 bp cut on outstanding loans that are consolidated (3a plus eliminate the 105 basis point fee)
3d. Borrowers pay new loan rate and protect FFEL lenders' current excessive returns on outstanding loans: FFEL consolidators are provided a T-Bill+3.1% SAP (80 bp SAP), and eliminate the 105 basis point fee

I. <u>July 1 Options If No Agreement Is Reached to Lower the Rate in Both Programs on Oct. 1</u>:

1. Lower the DL consolidate rate to T-bill +2.3% on July 1

<u>Pros</u>:

- Dramatically increases the chance that the rates will be lowered for both programs October 1 since Congress will be reluctant to raise rates for students
- No cost -- even produces small scorable savings although could lead to higher real costs if many more students consolidate
- Will receive strong support from students and the higher education community
- Is consistent with our current policy and our HEA proposal.

<u>Cons</u>:

- May anger Republicans who will claim it tilts the playing field between the two programs but we would have already given them a chance to negotiate a level playing field before acting
- Will need to clarify our regulation to make clear this was always our intention
- Will likely create more demand for DL consolidation than can be processed during the next three months
- May have a negative impact on the FFEL industry, although an 80 bp gap between the two programs existed prior to enactment of the two-way consolidation act last fall.

2. Keep the DL consolidation rate at T-bill +3.1% on July 1 and state our intention to lower the rate as planned on October 1.

<u>Pros</u>:

- Does not provoke a fight with Hill Republicans; keeps the playing field level
- Does not lead to excess demand for DL consolidation services.
- Saves $14 million if just for 3 months and saves $76 million if permanent
- Requires manageable system changes

<u>Cons</u>:

- Dramatically reduces our leverage to do better than the weighted average rounded up to the nearest 1/8 in both programs beginning October 1.
- Would cost students $300 million over 5 years on new direct consolidation loans if made permanent compared to lowering the DL rate.
- Students and the higher education community will strongly oppose it; miss an opportunity to help students.
- Is not consistent with our current policy or our HEA proposal. Congress had a chance to change our policy in ISTEA and chose not to change it.

- Ken Smith
- Bob Jones – Give Linus him...

+ Bob call MGA

- Leslie: Thomman:

703-684-9285

- Larry & A.R.
  - write the pitch to Larry:

This is nothing:
1. A needs already passed House
2. Conservatives [illegible]...
3. Jeffords deal

Dynamics - House...

- It's in your [illegible]
- You [illegible] it to the Circle [illegible]...
- [illegible] the [illegible] of workers like you...
- You are not getting [illegible]

OKYDKM
NKKKKYUIKYNHPKNBVCXSERTYIOP]YUYUY
UYUYUYUYUYUNMMMNMNNMMMMMMMMM
MCJHREWXXOPGTGFDRNM,KOREWQAX0
OPOOPKKKKKCCCCCWWWAAABBBHHJJK
KKKXXKJHGFDSAQWERTYUIOP[OOOO]PU
YTYUIKJJ

Plan to manage excess demand if rate is lowered on July 1:
Announce that we will guarantee the new low rate to all direct loan consolidation applications pending or received after the date of announcement. Between July 1 and October 1, we will increase capacity 50% and capacity will be doubled in the fall *[precise numbers and plan to come from SFA]*. If more applications are received than can be processed promptly, borrowers will be notified of the delay and of their options to consolidate with a FFEL consolidator if they need a consolidation loan more quickly. Notifications to this effect would also be included in the application packets sent to borrowers who request an application. The Department would not proactively take steps to increase demand during this three-month period.

Rejected options:

- CDSI consolidating previously consolidated DLs: requires systems changes that would take more than 4 months
- Using FFEL consolidators: requires interfaces with the DL CDS that would take months and a time consuming contract competition

II. Options for a Negotiated Agreement for October 1 (assume the same rate in both programs):

1a. Borrowers pay weighted average (similar to House HEA bill)

Pros:

- No or nearly no cost
- Over time the rate will drop as more new loans are outstanding

Cons:

- Does not give students with outstanding loans the benefit of the new low rate, costing students $___ over 5 years compared to lowering the rate in both programs based on our budget assumptions, and up to $__ over 5 years based on an assumption that all students would have consolidated or reconsolidated at the new loan rate.
- Is not consistent with our current policy or our HEA proposal.
- Weighted average is more difficult to implement from a systems perspective.

1b. Same as 1a plus origination fees are reduced/eliminated.

Pros:

- Current students benefit more and former students benefit less.
- Over time the consolidation rate will drop as more new loans are outstanding
- Saves students $2.4 billion over 5 years if origination fees are eliminated as in our HEA proposal, $1.7 billion if the first 1% (incl. GA insurance premium) is eliminated for all borrowers, and $880 million if the Harkin amendment were adopted.

Cons:

- Same as for 1a, but also costs the budget $1.4 billion over 5 years if origination fees are eliminated as in our HEA proposal, $700 million if the first 1% is eliminated for all borrowers, and the Harkin amendment costs $880 million and SAVES $100 million with Harkin's offset.

1c. 1a or 1b plus pay guaranty agencies fee from reserves to encourage consolidation of multi-lender accounts

Pros:

- No additional cost and encourages consolidation of loans where the benefits to borrowers and lenders are greatest

2. Borrowers in both programs pay new loan rate beginning October 1

Pros:

- Students win, saving students between $700 million-$5 billion over 5 years compared to current law (depending on whether more consolidate) and $___ over 5 years compared to House HEA bill
- Scorable savings of $50 million over 5 years if decision to consolidate is left up to borrowers and assuming

Cons:

- FFEL consolidators would not find it profitable, leading to FFELs being consolidated into DLs.
- DL would do most consolidation which would require a dramatic increase in DL consolidation capacity.
- Possible long-range increase in costs if market perceives the government as willing to make direct or indirect changes to the economics of outstanding loans.

3a. Borrowers pay new loan rate plus FFEL consolidators get the McKeon-Kildee rate (FFEL consolidators are provided the same 50 bp subsidy provided for new loans under the McKeon-Kildee proposal or under the final law if different)

Pros:

- Students win, saving students between $700 million-$5 billion over 5 years compared to current law (depending on whether more consolidate) and $___ over 5 years compared to House HEA bill

Cons:

- FFEL lenders still reluctant to consolidate because of 105 bp annual fee on consolidations
- Scorable cost of $750 million if the decision to consolidate is left up to the borrower. Could have up to a $4 billion cost if all outstanding loans were

consolidated or reconsolidated at the lower rate ($__in FFEL and $__ in DL). The likely cost is MUCH less (*Budget Service to develop a more likely estimate based on years left in repayment and loan balance)*

- Possible long-range increase in costs if market perceives the government as willing to make direct or indirect changes to the economics of outstanding loans.

3b. Borrowers pay new loan rate and FFEL consolidators would get the same for consolidations as for new loans but still pay a fee (3a plus cut the 105 basis point fee by 30 basis points)

Pros:
- Students win

Cons:
- FFEL consolidators will still protest since they may need to consolidate FFEL loans and pay the fee in order to keep some borrowers from consolidating into DL
- Scorable cost of $1 billion if the decision to consolidate is left up to the borrower. Could have up to a $5 billion cost if all outstanding loans were consolidated or reconsolidated at the lower rate ($__in FFEL and $__ in DL). The likely cost is MUCH less (*Budget Service to develop a more likely estimate based on years left in repayment and loan balance)*
- Possible long-range increase in costs if market perceives the government as willing to make direct or indirect changes to the economics of outstanding loans

3c. Borrowers pay new loan rate and lenders take a 30 bp cut on outstanding loans that are consolidated (Same as 3a and also eliminate the 105 basis point fee)

Pros:
- Students win
- FFEL lenders less disadvantaged (only 30 bps) compared to current rate on outstanding loans

Cons:
- Scorable cost of $2 billion if the decision to consolidate is left up to the borrower. Could have up to a $6 billion cost if all outstanding loans were consolidated or reconsolidated at the lower rate ($__in FFEL and $__ in DL). The likely cost is MUCH less (*Budget Service to develop a more likely estimate based on years left in repayment and loan balance)*
- Possible long-range increase in costs if market perceives the government as willing to make direct or indirect changes to the economics of outstanding loans

- assuming $3.8 billion in cons. / FF[illegible]
need to [illegible]...

3d. Borrowers pay new loan rate and protect FFEL lenders' current excessive returns on outstanding loans (Borrowers pay new loan rate, and FFEL consolidators are provided a T-Bill+3.1% SAP (80 bp SAP), and eliminate the 105 basis point fee)

Pros:

- Students win
- FFEL lenders would want to consolidate all multiple-lender loans (a minority of all loans) because lenders would not get any lower interest rate or pay a fee and would get the benefit of consolidation if they don't currently hold all of a borrower's loans (higher return for the same fixed servicing cost)

Cons:

- Excessive benefit to FFEL lenders?
- Scorable cost of $2 billion if the decision to consolidate is left up to the borrower. Could have up to a $8 billion cost if all outstanding loans were consolidated or reconsolidated at the lower rate ($__in FFEL and $__ in DL). The likely cost is MUCH less (*Budget Service to develop a more likely estimate based on years left in repayment and loan balance).*

Consolidation Loan Interest Rates

	Direct Loans	FFEL	FY 1998-03 Cost (OMB)
Before the Emergency Consolidation Act.	Interest rates set in regulation. T-bill + 3.1%, set annually, capped at 8.25%. **A typical borrower paid 8.25%.**	Weighted average of underlying loans rounded up to the nearest whole percent. **A typical borrower paid 9.0%.**	
Today. (Under the Emergency Consolidation Act.)	Interest rates set in regulation. T-bill + 3.1%, set annually, capped at 8.25%. **Borrowers pay 8.25%.**	T-bill + 3.1% set annually, capped at 8.25%. (Special allowance set quarterly.) **Borrowers pay 8.25%.**	n/a (in baseline)
July 1 -October 1. (Under the 3-month provision in ISTEA.)	Interest rates set in regulation. Estimate assumes T-bill + 2.3%. **Borrowers would pay 7.46%.**	T-bill + 3.1% set annually, capped at 8.25%. (Special allowance set quarterly.) **Borrowers would pay 8.25%.**	-$3 million (due to the difference between 10-20-year +1, which was assumed in the baseline for Direct Loans, and T-bill + 2.3%.)
October 1. (If no change in law - Emergency Consolidation Act would expire.)	Interest rates set in regulation. Estimate assumes the 10-20-year bond + 1%. **Borrowers would pay 7.11%**	Weighted average of underlying loans, rounded up to nearest whole percentage. These would be fixed rate loans; rates would not be reset annually. **A typical borrower would pay 9.0%**	n/a (in baseline)
House bill. (Manager's amendment.)	Weighted average of underlying loans rounded up to the nearest 1/8th of 1 percent, capped at 8.25%. (It appears that the House intends for the rate to be recalculated every year.) **A typical borrower would pay 8.25%.**	Weighted average of underlying loans rounded up to the nearest 1/8th of 1 percent, capped at 8.25%. (It appears that the House intends for the rate to be recalculated every year.) Annual special allowance set at T-bill + 3.1%. No quarterly special allowance. **A typical borrower would pay 8.25%.**	No cost. (CBO estimates that the cost will be $100 million.)

Senate bill.	Does not specifically address consolidation interest rates. Interest rates set in regulation. Estimate assumes T-bill + 2.3%. **Borrowers would pay 7.46%.**	Weighted average of underlying loans, rounded up to nearest whole percentage. These would be fixed rate loans; rates would not be reset annually. **A typical borrower would pay 9.0%**	-$34 million (due to the difference between 10-20-year +1, which was assumed in the baseline for Direct Loans, and T-bill + 2.3%.)
Administration HEA proposal.	T-Bill + 2.3%, set annually, capped at 8.25%. **Borrowers would pay 7.46%.**	T-Bill + 2.3%, set annually, capped at 8.25%. (Special allowance also set annually.) **Borrowers would pay 7.46%.** Lost revenue to lenders over 5 years would be $730 million. Current consolidated loan holder fee payments over 5 years would be $1.4 billion. Reducing the consolidated loan holder fee by 50% would keep lenders whole at a federal cost of approximately $700 million.	-$34 million (due to the difference between 10-20-year +1, which was assumed in the baseline for Direct Loans, and T-bill + 2.3%.)

June 8, 1998