

FOIA MARKER

**This is not a textual record. This is used as an
administrative marker by the William J. Clinton
Presidential Library Staff.**

Collection/Record Group: Clinton Presidential Records
Subgroup/Office of Origin: National Economic Council
Series/Staff Member: Bob Shireman
Subseries:

OA/ID Number: 13218
FolderID:

Folder Title:
Student Loan Reauthorization Options [3]

Stack:	Row:	Section:	Shelf:	Position:
S	15	1	11	1

Sept. 95 Labor/HHS Reconciliation Markup on Federal Student Loans

On Simon Reserve Amendment:

KASSEBAUM: "...real sympathy for what you are suggesting. I am just a little uncertain about how successfully we can do it right now."

KASSEBAUM: "...I think there is much merit [for Simon amendment]."

KASSEBAUM: "I think there is some interest in this [amendment]."

KASSEBAUM: According to the transcripts, the Chair was interested in Paul's ideas, and thought them worth pursuing.

COATS: "[Simon Amendment] idea has some merit."

COATS: "I do not know the ramifications; I do not know how the numbers come out...[but] willing to pursue issue with Simon or anyone else."

COATS: Thought contracting an "idea worth exploring."

COATS: Like KASSEBAUM, COATS was interested in Paul's amendment, but was unwilling to vote for the it without more study. He specifically mentioned his interest in hearing testimony from Department of Education, lenders and guaranty agencies.



UNITED STATES DEPARTMENT OF EDUCATION
WASHINGTON, D.C. 20202

PHONE: (202) 260-0438
FAX: (202) 708-8404

FACSIMILE TRANSMISSION COVER SHEET

-98 (label 1)
→ any bank required?

TO: Patricia A. Smith (202) 395-4875

FROM: Donald M. Feuerstein

RE: Draft of 11/5/96

DATE: 11/5/96

IF RE-TRANSMISSION IS NECESSARY
PLEASE CALL THIS OFFICE IMMEDIATELY.

MESSAGE: As you requested. Unfortunately, technology does not
always work. Best regards.

PAGE 1 OF 28



FFEL Management and Operations Subgroup
Proposed Recommendations for Reauthorization¹

Role and Financial Structure of Guaranty Agencies

ISSUE: Should the role and structure of guaranty agencies be substantially changed to improve their performance and efficiency?

BACKGROUND: Guaranty agencies presently perform the following functions for the following customers (more than one class of customers may benefit from certain activities):

1. Borrowers
 - a. Information about student financial assistance
 - b. Loan guarantees
 - c. Counseling (pre- and post-borrowing)
 - d. Default prevention
2. Schools
 - a. Training
 - b. Technical assistance
3. Lenders
 - a. Technical assistance
 - b. Claims payment
4. Department of Education
 - a. Default collection
 - b. Data collection and reporting
 - c. Monitoring of schools and lenders.

Guaranty agencies' agreements with the Secretary and funding are based on the assumptions that guarantying loans is their primary function, and they need to accumulate reserves to perform it. They are funded by a guaranty fee paid by borrowers (not to exceed 1 percent), transition support based on new volume (0.875 percent for FY97), a payment for successful supplementary pre-claims assistance (1 percent of the outstanding balance), a collections retention (27 or 19.5 percent) and interest on their reserve funds.

DISCUSSION: In fact, guaranty agencies do not perform a substantial guaranty function. Reinsurance and timely

¹No change from existing law is the implicit second option for all other recommendations.

claims reimbursement by the Department provide the vast bulk of the credit and funding for that function, and the remainder comes from the agencies' reserve funds, which are Federal property. In addition, §432(c) codifies the Secretary's direct responsibility for an insolvent agency's FFEL guarantees. Nevertheless, the current funding mechanism for the agencies results in aggregate reserve increases of some \$200 million annually. Not only is the holding of this magnitude of Federal property by the guaranty agencies unnecessary, but the Department must expend substantial resources to prevent its misuse. Moreover, the focus given to the purported guaranty function and its reserve funds and the mismatch between the agencies' revenue sources and the performance of their other functions make it difficult for the Department to maximize performance of the functions they actually do perform.

It has been suggested that the appropriate solution to this problem is elimination of the guaranty function and procurement of the remaining services through competitive bidding. This may someday be possible. Today, however, the guaranty agency network is still in the early stages of consolidation, and the Department has not yet developed appropriate quantitative performance measurements for the agencies' non-guaranty functions. Many of the existing agencies are State entities and/or multi-purpose organizations also involved in other areas of higher education and/or student financial assistance. Allowing for-profit entities to perform guaranty-agency functions and/or moving to the arm's-length relationship that would exist with Government contractors would be premature at this stage of the evolution. Moreover, there would likely be substantial support from lenders and some guaranty agencies themselves for an evolutionary approach, while an abrupt change to contractor status would probably be viewed as precipitous by all.

RECOMMENDATION: The funding and other relationships of the guaranty agencies with the Department should be substantially restructured to treat them more like contractors without totally abandoning the current framework. In particular:

1. **Term:** The Secretary's agreements with guaranty agencies should no longer be for an indefinite term, subject only to termination under §428(c)(9)(B), as is currently the case. Since FFEL itself usually changes substantially with each reauthorization, all guaranty-agency agreements should expire at that time.
2. **Capitalization:** The reserve-fund ratio requirements

of §428(c)(9)(A) should be replaced by a concept of working capital. All guaranty agency reserve funds should be returned to the Secretary, and each agency should be given new working capital equal to one-half of its FFEL expenses for the preceding four quarters.

3. Revenues: The Secretary should pay each guaranty agency \$__ for each new guarantee and \$__ for each borrower account on a quarterly basis. Its only other sources of FFEL revenue should be a default-prevention fee paid by lenders (see p. __, below) and interest on its working capital. [The fate of the guaranty fee will be considered by the level playing-field subgroup.]
4. Claims float: Section 428(c)(1) requires a guaranty agency to file for reinsurance within 45 days after it pays a lender claim. Guaranty agencies currently require some \$300 million in working capital to finance the claims process for the 90 day period between their payments to lenders and reimbursement of those claims by the Department. [This recommendation and the possible alternative of achieving the same result by regulation will depend on the scoring consequences of any change.]
5. Return of excess working capital: At the end of each quarter, guaranty agencies should return to the Secretary any working capital exceeding one-half of their cumulative expenses for that and the preceding three quarters (less the incentive retentions described below).
6. Incentives: The obligation to return all excess working capital to the Secretary would neutralize not only the new incentive provided by the default-prevention fee but also the current incentive for guaranty agencies to maximize their revenues and minimize their expenses in order to increase their reserve funds. To provide new incentives, they should be allowed to transfer to a special fund 100 percent of their default-prevention fees and __ percent of the excess working capital (after transfer of the default-prevention fees) that would otherwise have been returned to the Secretary. These funds might be spent on a State grant program, a conventional loan program or any other educational program approved by the Secretary. The default-prevention fee would provide a special incentive for guaranty agencies to return delinquent loans to current-payment status. For the reasons set forth at page __, below, no additional incentive for default reduction is

Set by
Cayrese
10
Secy?

Good

Don't want to keep
costs down...
BUT could Congress
Secy even reduce
the point??

recommended. Nevertheless, the existence of a non-Federal fund subject to any adverse action for faulty claims review should provide a better incentive for that aspect of default reduction.

7. **Advances:** The Secretary should have authority to advance additional working capital for extraordinary capital expenditures or emergency needs from prior returns of excess working capital, rather than from the §458 administrative fund for both loan programs, as is currently authorized.

Other Areas

1. Loan Access

ISSUE: Should the current system to insure that every eligible student attending an eligible institution has access to a student loan be strengthened?

BACKGROUND: The current system to insure loan access is a combination of voluntary cross-subsidization by private lenders, the FFEL lender-of-last-resort program under §§ 428(j) and 439(q) and more recently the potential availability of DL for schools that cannot obtain service under FFEL. In addition, although other lenders are not precluded from economic discrimination under §421(a)(2), secondary markets using tax-exempt financing are currently required by §438(e)(2) to deal with all eligible lenders in their service areas on the same terms and conditions. Within the limits of their capital, they are also required to purchase all eligible loans involving students or schools within those areas. Those secondary markets and Sallie Mae are also prohibited by §§438(e)(3) and ___ from discrimination on the basis of the borrower's income, the school attended, the length of the academic program or the academic year in school. Although there have not been any major access problems to date, several recent developments have potentially weakened this safety net; and further adverse developments may occur.

- a. A series of subsidy reductions by Congress have reduced the excess profit in desirable loans. This trend may continue.
- b. Price competition among lenders and with DL and profit-sharing with school "lenders" has further eroded the excess subsidy.
- c. Sallie Mae will either privatize and shed its LLR obligations or liquidate. Other secondary markets may leave FFEL as a result of the Nellie Mae tax legislation.

- d. DL does not accept all eligible schools, and any future volume caps could limit its ability to do so. DL cannot serve particular students unless their school applies for the program.

DISCUSSION: There is no way to know whether a safety net is actually sufficient until a large problem has tested it. Such an approach in this case could be very unfair to the students whose lives might be unalterably changed by not being able to pursue a post-secondary education at the time of their choosing. On the other hand, the appropriate amount of insurance to hold against a risk depends upon the magnitude of the premium as well as the magnitude of the risk. In this case, since it is not known whether the reductions in the existing safety net will in fact be problematical, any improvements should have minimum pre-problem costs. Finally, although access problems could be totally eliminated by imposing mandatory service requirements on all lenders, that would be a drastic change in the current structure of FFEL and would generate enormous opposition.

RECOMMENDATION: The current system for ensuring loan access should be strengthened as follows:

- a. The current \$2 billion volume cap on FISL in §424 should be increased to \$_____, and whatever other changes are necessary should be made so that this program will be a viable alternative for loan access problems.
- b. The nondiscrimination provisions should (1) be clarified by specifically providing that these secondary markets must offer to purchase any current eligible loan offered to them at no less than par plus accrued interest and (2) be expanded to apply to all secondary markets. They should not be required to pay the same price for all loans, because that would enable other lenders to game the system by selling only their less desirable loans to the secondary markets. Budget Service believes that the risk of substantial access problems is not sufficiently great to justify further intrusion in the voluntary nature of the lender function.
- d. Because the LLR provision for guaranty agencies in §428(j)(1) is limited to subsidized loans, the Department has interpreted that limitation as applicable to the entire LLR program. The program should be expanded to cover unsubsidized loans.
- e. The Secretary should be authorized to make advances directly to lenders for LLR loans, rather than having to use guaranty agencies as intermediaries,

as currently provided by §428(j)(3).

- f. The Secretary should be authorized to make DL loans as LLR irrespective of the school's nonparticipation in the program or any volume cap.
- g. If guaranty-agency trigger rates are retained for any purpose (see p. __, below), guarantees of LLR loans and guarantees transferred under a plan approved by the Secretary should not be included in the computation of reinsurance rates, as they are currently. Compare §§428(c)(1)(E) and (F) with §428(c)(1)(C).

2. Comparable maturity

ISSUE: Should the approach for determining comparable maturity be changed?

BACKGROUND: The concept of comparable maturity is extremely important in determining the cost of both FFEL and DL loans to students and the Department. Section 427A(h) changes the reference rate for determination of the interest rate for FFEL loans made after July 1, 1988, to the bond-equivalent rate for securities with a "comparable maturity." This concept is already used in determining the cost of funds charged to the Department for DL and the rate used to discount future revenues and expenses (including defaults) under Credit Reform. OMB views the 10-year Government bond as the comparable maturity to FFEL loans.

DISCUSSION: The 10-year Government bond pays interest quarterly and principal in a single balloon payment at maturity. FFEL and DL loans normally pay interest quarterly, but interest is sometimes accrued or capitalized. The principal, however, is amortized over the term of the loan, although that term can be extended under certain circumstances. In economic terms, FFEL loans are probably most comparable to the 5-year bond. In the absence of further experience with ICR, the same is probably true of DL loans, also. Currently, the spread between the 5- and 10-year bonds is 0.30 percent.

*Richard P. ...
94045
??*

The principles that Government programs are scored on the basis of an arbitrary transfer price of funds from the Treasury rather than the Government's actual borrowing cost, and that the same transfer rate is also used as the discount rate under Credit Reform are applicable Government-wide and

almost impossible to change for a single program. The inclusion of the term "comparable maturity" in the HEA and the need to define the term, however, provide an opportunity to reduce the cost of FFEL loans to students by selecting a shorter maturity and hopefully influence the result for the other purposes as well.

RECOMMENDATION: The reference to "comparable maturity" in §427A(h) should be expanded to provide that comparable maturity is to be determined on the basis of average life rather than final maturity.

3. Conflicts of interest:

ISSUE: Should the statutory authority for the Secretary to deal with conflicts of interest by guaranty agencies be changed?

BACKGROUND: A number of guaranty agencies are involved in potential conflicts of interest by virtue of the conduct of other related activities in the guaranty agency itself or other entities affiliated with the guaranty agency or with directors, officers or employees of the guaranty agency. Serious abuses of these relationships have been uncovered in the past, particularly in the quality of claims review by the guaranty agency of related lender and lender-servicing activities and in the prices at which goods and services have been transferred. The Department has recently issued an NPRM that would provide further protections against, but not prohibit, such conflicts of interest.

DISCUSSION: There is considerable support for a "bright-line" provision prohibiting a guaranty agency from having any affiliation with a lender or lender-servicer and perhaps from having any transactions with a related entity. OGC believes that the Secretary has current statutory authority to impose such a prohibition under §432(a)(3). The NPRM, however, proposes only further regulation at this time, although it does solicit comment on the stricter alternative and reserves it as a later possibility if further regulation does not solve the problem. It could be viewed as bad faith for the Department to propose strict separation shortly after declining such action, if the Secretary does so. Thus, no further action should be taken on the subject at this time. The existing statutory requirement in §432(p) for the reporting of conflicts of interest by guaranty-agency personnel has never been implemented, is overly burdensome and should no longer be necessary in light of the new regulations.

RECOMMENDATION: The existing reporting requirement should be repealed.

4. Data collection

ISSUE: Should the Secretary have additional authority to ensure the timeliness and accuracy of data reported by the guaranty agencies?

BACKGROUND: The Department has had long-standing difficulties in obtaining timely, accurate loan and other data from the guaranty agencies. These difficulties have caused particular problems for NSLDS. Although periodic reconciliations of accounts by guaranty agencies and lenders would be helpful in this regard, OGC believes that the Secretary already has authority to require them under §§428(c)(2)(B) and 432. It would also be useful if the Secretary could condition payment of guaranty-agency subsidies on the furnishing of timely, accurate data; but differences in the language of the former ACA authorization in §428(f), the present transition-support authorization in §458(a) and FY96 and FY97 appropriations leave the status of such authority unclear.

RECOMMENDATION: The Secretary's authority to condition guaranty-agency subsidy payments on timely, accurate reporting of loan and other information should be clarified.

5. Default Reduction

a. Payments to guaranty agencies

ISSUE: Should the payments to guaranty agencies for default prevention, default collections and loan consolidation be changed to improve the incentivization of performance?

BACKGROUND: Guaranty agencies currently receive nothing for successful preclaims assistance, 1 percent for successful supplemental preclaims assistance under §428(1)(2), 27 percent of default collections §§428(c)(2)(D) and (6) and 18.5 percent for loan consolidation as a matter of interpretative position.

DISCUSSION: The current payment structure does not incentivize desired performance. Default prevention is perhaps the most important guaranty-agency function for both the borrower and the Government. Guaranty agencies should be strongly incentivized to pursue that function. Requiring lenders to pay for guaranty-agency default-prevention rather than the Department will further incentivize the lenders to

perform their own default-prevention responsibilities for delinquent loans before they refer them to the guaranty agencies for pre-claims assistance. OPE believes that it can collect defaulted loans at least as efficiently as the guaranty agencies, and the Secretary already has authority under §428(c)(8) to subrogate all defaulted loans. The Department has not done so only because of capacity limitations and the role of collections retention in the current financial structure of guaranty agencies. If guaranty agencies are restructured as recommended above (see p. __), there is no need to provide an incentive for collections in addition to cost reimbursement and potential subrogation. Similarly, as the current competition between FFEL and DL becomes less emotional, it should not be necessary to provide an incentive in addition to cost reimbursement for loan consolidation, either.

RECOMMENDATION: Payments to guaranty agencies should be changed as follows:

- (1) Lenders should be required to pay guaranty agencies \$__ per borrower account for any delinquent loan(s) returned to timely payment by the agencies.
- (2) Options for funding collection and consolidation
 - (a) If guaranty-agency funding is restructured (see p. __, above), expenses for collection and consolidation would already be funded. No further revenue is necessary for these functions.
 - (b) If guaranty-agency funding is not restructured, the collection retention should be reduced to __ percent, and the payment for consolidation should be reduced to __ percent. To simplify the retention formula, these percentages would apply to all collection proceeds, regardless whether they represent the insured portion of principal and accrued interest, the uninsured portion or collection charges added to the outstanding balance.
 - (c) If the retention for consolidation is neither eliminated nor reduced, the Department's current interpretative position that the retention may not exceed 18.5 percent should be codified to eliminate further disputes with the guaranty agencies.

b. Risk sharing (insurance and reinsurance rates)

ISSUE: Should the level and/or structure of risk sharing by lenders and guaranty agencies be changed?

BACKGROUND: To incentivize default prevention, lenders are required by §428(b)(1)(G) to absorb 2 percent of all defaults. Under _____, the entire guaranty is subject to cancellation for failure to comply with strict process-oriented due-diligence requirements promulgated by the Secretary. Guaranty agencies are similarly required by §428(c)(1) to absorb 2 percent of all claims payments (2 percent of 98 percent), but their risk sharing is funded by their reserve funds. If their default rates exceed certain 5 or 7 percent "triggers," §428(c)(1)(B) reduces the level of reinsurance, respectively, to 88 or 78 percent. Their reinsurance by the Department may similarly be lost under §____ for due-diligence failures.

DISCUSSION: The Department's current due-diligence regulations are considered by some to be overly prescriptive and insufficiently effective. The Draconian nature of guaranty cancellation as a sanction has led to frequent compromises. In the case of guaranty agencies, the sanction is normally imposed on the reserve fund rather than on any non-Federal guaranty-agency funds anyway. As a result, OPE has a radical revision of the due-diligence regulations on its work calendar for this year. For lenders, increased risk sharing would be a better method of achieving due diligence. Since guaranty agencies, on the other hand, do not perform a substantial guaranty function, risk sharing is not the best method of incentivizing other related functions, such as monitoring of schools and claims review. The current system of increasing the level of risk sharing by a series of "trigger rates" for high levels of default, is subject to gaming and generally has not been effective. The President's FY97 budget proposes reductions in insurance and reinsurance to 95 and 96 percent, respectively.

RECOMMENDATION: Risk sharing should be changed as follows:

- (1) Lender insurance should be reduced to 90 percent, and the Secretary should be directed to review the existing due-diligence regulations and sanctions in light of this change.
- (2) Guarantor reinsurance should be increased to 100 percent of claims payments.
- (3) Options for reductions in guarantor reinsurance
 - (a) Even if guarantor risk sharing is

retained, reduction in guarantor reinsurance rates for hitting default rate "triggers" should be repealed.

- (b) If reductions in guarantor reinsurance are retained, (i) the reductions should be in effect for an entire quarter and be computed on the basis of the rolling previous _____, (ii) the "triggers should be reduced to _____ and _____ percent and (iii) the Secretary should be given authority to define the numerator and denominator of the default percentage.

6. Designation of guaranty agencies:

ISSUE: Should the Secretary have explicit discretion to select guaranty agencies?

BACKGROUND: Section 428(b)(1) authorizes State or private, nonprofit entities to enter interest subsidy agreements with the Secretary upon certain findings by the Secretary, and §428(c)(1) authorizes the Secretary to enter into guaranty agreements. Section 428(g) sets a time limit for the Secretary to act on an application by a private, nonprofit entity to enter into these agreements. The statute does not explicitly address the Secretary's discretion to select guaranty agencies.

DISCUSSION: The Secretary's discretion is implicit in these provisions, and the Secretary has in fact declined to accept a Governor's recommendation in a small number of cases. Nevertheless, on at least one occasion Congressional staff have questioned the Secretary's discretion

RECOMMENDATION: The Secretary's discretion in designating guaranty agencies should be made explicit.

7. Enforcement

a. Delegation of functions/responsibilities

ISSUE: Should further limitations be placed on the delegation of functions and responsibilities by lenders and guaranty agencies to third parties?

BACKGROUND: Lenders and guaranty agencies commonly delegate some or all of their functions to third parties. Sections 426 and 481(f) and _____ specifically contemplate the roles of trustee banks and third-party servicers, and the Secretary has regulated their functions. Some lenders and guaranty agencies have in fact delegated all or substantially all of

the functions inherent in their participation in FFEL in those capacities, which is inconsistent with the establishment of eligibility qualifications in HEA for those participations. Although the Secretary's regulations provide in 34 CFR §682.203(a) that delegation does not relieve the eligible participant from its compliance responsibilities under the statute and regulations, the delegating parties are normally indemnified by their delegees and rarely actually monitor their activities.

DISCUSSION: Although delegation of all or substantially all of a lender or guaranty agency's functions to a third party is objectionable in principle, current arrangements that have been approved or at least condoned for many years would have to be undone or grandfathered. For example, __ States have multiple secondary markets through the use of trustee banks, even though §435(d)(1)(D) authorizes only one eligible secondary market per State. Attempting to draw the line between permissible and impermissible delegations would be a difficult task. Moreover, in the case of lenders, the use of trustee banks is necessary for the use of modern financing techniques, such as securitization. A less severe alternative would be a requirement that the eligible participant actively monitor the activities of its delegee(s) coupled with a prohibition against indemnification of the eligible participant in the absence of adequate supervision. Although OGC believes that the Secretary already has authority to promulgate a regulation to this effect, a statutory provision would be preferable in light of the impact on long-standing arrangements. There are precedents in other areas of the law for supervisory responsibilities and the identification of situations in which indemnification is against public policy.

RECOMMENDATION:

(1) Options:

- (i) The majority of the working group would not restrict the current authorization for delegation of functions. They do, however, recommend that eligible lenders and guaranty agencies should be required to monitor the activities of third parties to which they delegate functions and should be prohibited from being held harmless from loss from those activities in the absence of adequate supervision.
- (ii) Budget Service, OGC and OMB do not believe that the Government should be concerned with private lenders' cost of funding and recommend that the trustee-

bank provision be repealed. They do however, agree with the majority recommendation for increasing legal and financial responsibility for those delegations that would still be permitted.

b. Fines

ISSUE: Should the Secretary's power to fine lenders and guaranty agencies be expanded?

BACKGROUND: Section 432(g) authorizes the Secretary to impose a civil penalty on a lender or guaranty agency after notice and an opportunity for a hearing. Although the Secretary may impose a penalty of up to \$25,000, all violations relating to the same practice or policy must be treated as a single violation no matter how many borrowers are hurt. Moreover, in order to impose any penalty whatsoever, the Secretary must show that the violation is material, and that the lender or guaranty agency knew or should have known that it was violating the law. Finally, no penalty may be imposed if the lender or guaranty agency corrects the violation prior to receiving notice from the Department that it intends to levy a civil penalty, even if the correction occurs only after knowledge that the Department is preparing action.

DISCUSSION: These limitations on the Secretary's authority are not common in similar provisions for other Government agencies, in some respects are not even applicable to the Secretary's authority to impose civil penalties on schools and unduly hinder the exercise of the Secretary's statutory authority.

RECOMMENDATION: The limitations described above on the Secretary's authority to impose civil penalties on lenders and guaranty agencies should be eliminated.

c. Substance versus form

ISSUE: Should the Secretary have explicit authority to evaluate transactions and arrangements on the basis of their substance over their form?

BACKGROUND: Although the Secretary has general authority to promulgate regulations under §432(a)(1), there is no explicit authority to define statutory terms. Nor does the HEA explicitly authorize the Secretary to interpret eligibility and other statutory requirements and prohibitions to carry out the underlying statutory purpose in relation to the actual substance of transactions and

arrangements rather be limited to evaluating them on the basis of their form. Accordingly, it is not uncommon for FFEL participants to devise formal structures that appear on their surface to satisfy the statute but are inconsistent in substance with the statutory purpose.

DISCUSSION: Although the Secretary already has implicit authority to evaluate transactions and arrangements on the basis of their substance, explicit statutory authority would make it easier for the Department to support those decisions in judicial review.

RECOMMENDATION: The Secretary should have explicit authority to evaluate transactions and arrangements on the basis of their substance over their form.

8. Lender eligibility:

a. Schools

DISCUSSION: Should the eligibility of schools as lenders be further restricted?

BACKGROUND: Schools are currently eligible under §435(d)(2) to be FFEL lenders if they use their interest and special allowance receipts for need-based grant programs. They may not make loans to more than 50 percent of their undergraduate students, however, and then only to students who have previously been turned down by another eligible lender.

DISCUSSION: Schools are required to counsel their students about their loans both before and after the borrowings. When the school has a direct financial interest in the loan (over and above the inherent financial interest in receiving tuition income), it has a serious conflict of interest in performing its counseling role. In principle, the other elements of the safety net for loan access should obviate any need for schools to act as lenders. Unfortunately, the number of major educational institutions that are currently considering becoming lenders or are already so is growing rapidly, and an outright prohibition might not be possible in the absence of a grandfather list so long as to engulf the prohibition. On the other hand, there seems to be even less need for schools to make loans to their own graduate and professional students than to their undergraduates.

*Also - 1994
way for more
experience for
students*

RECOMMENDATION: The current limitations on the eligibility of schools to make loans to their own undergraduate students should be extended to graduate and professional students, also.

b. Other lenders

QUESTION: Should the eligibility requirements for non-school lenders be changed?

BACKGROUND: In theory, with the exception of schools, lender eligibility is essentially limited by §435(d)(1) to various regulated financial institutions, State agencies or a single private, nonprofit agency designated by a State. In practice, any person or entity may substantively become a lender by use of a trustee bank (see page __, above).

DISCUSSION: For the reasons stated above, the use of trustee banks should not be eliminated. Accordingly, the current limitations on lender eligibility do not restrict the availability of all potential loan capital to FFEL. Nor is there any need to establish capability requirements for lender eligibility, as there is for school eligibility. On the other hand, it is useful to limit the parties that may assume legal responsibility for lender compliance with the HEA and the Secretary's regulations.

RECOMMENDATION (OPTIONS):

- (1) The majority of the working group believe that the current provision for the eligibility of non-school lenders should not be changed.
- (2) Budget Service, OGC and OMB believe that the regulation of insurance companies is not sufficient for a consumer-loan business, and that a number of problems have arisen in FFEL as a result. They recommend that the eligibility of insurance companies as lenders in §435(d)(1)(C) be repealed.

9. Miscellaneous:

a. Budget status of transition support

ISSUE: Should transition support be a discretionary or mandatory payment? [This is William Graham's issue. He should provide the initial draft.]

b. Insurance level

ISSUE: Should the specification of guaranty agency insurance level be clarified to be a maximum as well as a minimum?

BACKGROUND: Prior to the 1993 Amendments, §428(b)(1)(G) required guaranty agencies to insure "not less than 100 percent of the unpaid principal" of FFEL loans. When lender co-insurance was introduced, the percentage was reduced to

98 without otherwise changing the language.

DISCUSSION: The clear legislative intent in making the change was to impose the discipline of 2 percent co-insurance on lenders and to limit the exposure of the Government to 98 percent. Some guaranty agencies have read the change narrowly to continue to allow them to offer 100 percent insurance, paid out of their reserve funds, if they choose; and one agency is litigating this issue with the Department.

RECOMMENDATION: The Department's interpretation of the current provision as setting a fixed insurance right should be specified in the statute.

10. Nonfunctioning programs:

ISSUE: Should a group of nonfunctioning programs be eliminated?

BACKGROUND: There are a number of programs that have either never been implemented or are no longer performing any substantial function. They are:

- a. Assistance for borrowers in §432(k) (encouragement of employers to assist borrowers in repaying loans; never implemented)
- b. District of Columbia Loan Program in §456 (loans currently guaranteed by Massachusetts guaranty agency under normal FFEL program)
- c. Doing-business plans by secondary markets using tax-exempt financing in §438(e) (little useful information and inadequate Department resources to review them; substantive limitations (see p. __, above) to be retained)
- d. Exceptional performers in §428I (100 percent insurance for lenders, servicers and guaranty agencies whose compliance-performance rate exceeds 97 percent; never implemented, and other incentives sufficient)
- e. Federal advances to guaranty agencies in §422(a)-(f) (only \$38 million still outstanding with complicated statutory provisions)
- f. Lender referral services in §428(e) (payment to guaranty agencies for referring students to borrowers; never implemented, and guaranty agencies already legally required to be LLR's or find other lenders to be so)

g. Payment for supplemental pre-claims assistance in §428(1)(2) (1 percent of the amount collected; limited to a specific time period in a guaranty agency's default-prevention efforts; replaced by the new default-prevention fee (see p. __, above)).

DISCUSSION: No reason exists for the continuation of the statutory authority for any of these programs.

RECOMMENDATION: The group of non-functioning programs should be eliminated.

11. Reserve funds and assets:

a. Definition

ISSUE: Should the current regulatory definition of "reserve funds and assets" be codified?

BACKGROUND: Since 1986, the regulations under the HEA have defined reserve fund and assets in 34 CFR §682.410 in terms of sources and uses of guaranty-agency funds. In 1994, this regulation was substantially revised in a negotiated-rulemaking proceeding that achieved consensus. In that proceeding, however, the guaranty agencies reserved their right to challenge the legality of the revised regulation.

DISCUSSION: Under §422(g)(1), a guaranty agency's reserve fund and assets are Federal property. The definition of these terms is one of the most important in FFEL, and any controversy about its legality should be eliminated.

RECOMMENDATION: The current regulatory definition of "reserve fund and assets" should be codified.

b. Federal property interest

ISSUE: Should superceded statutory language that is arguably inconsistent with the Federal-property interest in guaranty-agency reserve funds and assets be repealed?

BACKGROUND: Section 422, which provided for Federal advances to guaranty agencies, had a matching requirement in subsection (a)(2), which could be met out of "the unencumbered non-Federal portion of a reserve fund," and discretionary authority in subsection (a)(3) for the

Secretary to require repayment of the advances. Most guaranty-agency assets, other than actual Federal advances and the earnings on the advances, would fall within this definition. In 1992, after the 1988 and 1989 spend-down recalls of reserve funds, the guaranty agencies persuaded Congress to insert the following provision in subsection (a) (3):

"Except as provided in section 428(c) (10) (E) or (F) [the provisions for terminations of guaranty agencies], such unencumbered non-Federal portion shall not be subject to recall, repayment, or recovery by the Secretary."

In 1993, Congress added subsection (g), clarifying the Federal property interest in reserve funds and assets without limitation. Nevertheless, the guaranty agencies have continued to rely on the superceded provision, and it was used as the basis for the aborted \$1.8 billion reserve-fund giveaway in FY96 budget reconciliation.

DISCUSSION: This superceded provision no longer serves any purpose. Indeed, we have already recommended that the entire structure for Federal advances be repealed (see p. __, above).

RECOMMENDATION: If §422(a)-(f) is not repealed in its entirety, the definition of "unencumbered non-Federal portion" should be eliminated.

c. Fiduciary status

ISSUE: Should the fiduciary status of guaranty agencies be codified?

BACKGROUND: A fiduciary is a person who holds the assets of another for limited uses. A fiduciary has stricter responsibilities with respect to those assets than persons in other legal capacities. The fiduciary status of guaranty agencies is implicit in the limited uses to which their reserve funds and assets can be put and the Federal property interest in those funds and assets. Although numerous court decisions, primarily in the spend-down cases, support the Department's view of guaranty agencies as fiduciaries, it is

not explicitly provided in the HRA. The guaranty agencies themselves continue to deny that they are fiduciaries.

DISCUSSION: This, too, is a fundamental concept in the regulation of guaranty agencies and should be beyond question.

RECOMMENDATION: The fiduciary status of guaranty agencies should be codified.

d. Recall

ISSUE: If guaranty agencies retain any reserve funds (see p. __, below), should there be a partial recall?

BACKGROUND: Although §422(g)(1)(A) authorizes the Secretary to recall "unnecessary" reserve funds, 34 CFR §682.417, the regulation that was negotiated to implement that authority requires a reserve ratio in excess of 2.0 percent and requires a protracted procedure. A new statutory recall of \$600 million was included in the President's FY97 budget. According to our latest reserve fund projections from the guaranty agencies, their aggregate reserves as of FYE97 should be \$2.1 billion against a portfolio of outstanding guarantees in the aggregate original principal amount of \$140 billion. This would result in an aggregate reserve ratio of 1.5 percent, as compared to the statutory requirement of 1.1 percent. These projections were made in FY95 and are probably obsolete, but they are the best data that we presently have.

DISCUSSION: For the reasons stated earlier (see pp. __, above), guaranty agencies should hold the minimum amount of Federal property necessary for working capital purposes. Based on the above projections, the maximum recall that would be possible without creating a reserve-ratio violation on an aggregate basis would be just under \$600 million. Reserve ratios must be individually maintained by each guaranty agency, however; and, depending on the allocation formula, even a \$600 million recall could put a number of guaranty agencies into violation. Accordingly, any recall should also authorize the Secretary to waive the reserve-ratio requirements and substitute a system of working-capital requirements.

RECOMMENDATION: Any substantial recall of reserve funds should be accompanied by a change in the capital requirements for guaranty agencies. If that is done, the recall could be substantially increased.

e. Resignation

ISSUE: Should the Secretary's implicit authority to require the return of guaranty-agency reserve funds and assets and the assignment of its guaranty portfolio upon the voluntary resignation of a guaranty agency be made explicit?

BACKGROUND: Section 428(d)(9)(F) provides that, when a guaranty agency's agreement is terminated, the Secretary shall assume responsibility for all functions of the guaranty agency, including using all funds and assets of the guaranty agency, permitting the transfer of its guarantees to another guaranty agency and taking any other action necessary to ensure the full honoring of its guarantees. There is no comparable provision for the resignation of a guaranty agency.

DISCUSSION: Congress could not have declared guaranty agency assets and reserves to be Federal property and then allowed guaranty agencies to retain them simply by resigning. Unless the Secretary had the same authority upon resignation as upon termination, a guaranty agency fearing termination would simply resign before the Secretary could act. Although, the Secretary's authority is implicit in the statutory scheme, an explicit provision would avoid unproductive dispute.

RECOMMENDATION: The Secretary's implicit authority over a guaranty agency's reserve funds and assets and guaranty portfolio upon its resignation should be made explicit.

f. Retroactivity

ISSUE: Should the retroactivity of the Federal property interest in guaranty-agency assets and its applicability to assets developed with reserve funds and assets be explicitly codified?

BACKGROUND: Although the 1986 regulation (see p. __, above)

was not explicitly retroactive, the Department has always interpreted it as such. In 1992, the Department amended the regulation to clarify the Federal property interest in assets "developed" with reserve funds (such as computer software or lender-servicing businesses) as well as those "purchased" with reserve funds. As enacted in 1993, §422(g) is also not explicitly retroactive and refers only to "purchased" assets. The regulation in 34 CFR 682.410 that was negotiated to implement that statutory provision includes "developed" assets and a new provision granting relief from retroactive application under certain limited circumstances. The Secretary's agreements with guaranty agencies are explicitly subject to the HEA and and Secretary's regulations as they exist from time to time. Despite the consensus reached in the 1994 negotiated rulemaking, individual guaranty agencies continue to question the retroactive application of one or more of these provisions.

DISCUSSION: Pre-1986 interest on reserve funds and property "developed" with reserve funds represent significant Federal property.

RECOMMENDATION: In codifying the regulatory definition of "reserve funds and assets" (see p. __, above), the retroactivity of the definition should be made explicit.

12. Sallie Mae:

a. Offset fee

ISSUE: Should the obligation of Sallie Mae to pay an offset fee on securitized loans be clarified?

BACKGROUND: Section 439(h)(7) imposes an offset fee of 30 basis points on FFEL loans that Sallie Mae acquired after the 1993 effective date and still "holds." This provision was scored at a \$__ billion saving in the 1993 budget reconciliation. To reduce the cost of financing, Sallie Mae has been "selling" a substantial portion of its loan portfolio to trusts that issue securities to third parties. Sallie Mae continues to service the loans and retains substantial residual interests in the trusts. On one set of hypothetical facts the Secretary ruled that Sallie Mae still held the securitized loans for purposes of the offset fee.

A Federal district court has held that securitized loans are no longer subject to the offset fee. The decision is now on appeal.

DISCUSSION: The offset fee was imposed in recognition of Sallie Mae's substantial advantages as a Government-sponsored enterprise both to reduce the deficit and to offset Sallie Mae's lower cost of funds than many of its competitors. If securitized loans are not subject to the offset fee, Sallie Mae will securitize as much of its FFEL loan portfolio as possible, and the Congressional purpose will be frustrated.

RECOMMENDATION: If the erroneous lower court decision is upheld on appeal, §439(h)(7) should be amended to clarify its applicability to securitized loans.

b. Other changes

ISSUE: Should other changes be made in the provisions governing Sallie Mae in light of the recent authorization for its privatization?

BACKGROUND: The FY97 appropriations law requires Sallie Mae to convert from a GSE to an ordinary business corporation by 2008. If it does not do so, it must liquidate by 2013. As a GSE, Sallie Mae's functions are limited by §439(d). The Department has a number of ongoing disputes with Sallie Mae, particularly with respect to whether the "pipelines" that it has established with schools and other lenders constitute unlawful origination of FFEL loans by Sallie Mae or prohibited inducements of other lenders.

DISCUSSION: Although all open issues with Sallie Mae are not free from doubt, OGC believes that the Department has sufficient authority under existing legislation to resolve these issues favorably. In view of Sallie Mae's effectiveness at lobbying activities, it would be preferable for the Department to advance its current positions administratively and judicially. The privatization legislation does not create any new problems that are not dealt with in the legislation itself.

RECOMMENDATION: No further legislation is necessary with respect to Sallie Mae.

13. Subsidies to lenders:

a. Adjusted interest rates

ISSUE: Should an erroneous court decision that lenders may use adjusted interest rates to retroactively claim special allowance payments be corrected?

BACKGROUND: In 1986 and 1992, Congress modified the HEA to require lenders to provide borrowers with fixed rate FFEL loans with a rebate when the interest rate on those loans exceeded the market rate the lenders would otherwise have received on a loan (as approximated by a statutory formula). The lenders, however, claimed that their computer systems could not compute the rebates and failed to provide this benefit. To address this problem, in 1993, Congress amended the HEA to require the lenders to retroactively calculate a variable interest rate for the affected loans and then repay the borrower the difference between the variable rate and the fixed rate as a rebate. After doing this calculation, a number of large FFEL lenders sued the Department in Federal court claiming that they should be permitted to use the variable interest rate calculated for these borrowers to retroactively calculate the special allowance payment they receive from the Department. The District Court ruled in favor of the lenders and rejected the Department's conclusion that the new variable rate was only intended to be used to benefit the borrowers and was not intended to change the rules governing special allowance payments. This incorrect interpretation will cost the taxpayers approximately \$32 million in unnecessary special allowance payments to lenders.

DISCUSSION: The District Court decision is contrary to the intent of Congress which only intended to ensure that borrowers received the benefit of the excess interest rebate that they should have received. The Court's decision puts the Department to repay the lenders for the cost of the rebate through the special allowance payment. This turns the purpose of the rebate provision upside down.

RECOMMENDATION: Section 427A(e)(7) should be clarified to provide explicitly that the interest rate created under that provision is designed only for the purpose of providing the borrower with the benefit of the excess interest rebate and

is not used for calculating special allowance payments.

b. Fees

ISSUE: Should lender fees be increased and/or be directly collectible?

BACKGROUND: Section 438(d) imposes a lender origination fee of 0.50 percent on all loans made after FY93. Subsection (d)(1) restricts the collection of the fee to a deduction from payments of interest and special allowance to the lender. The President's budget for FY97 included an increase in the origination fee to 0.80 percent and proposed a new semiannual holding fee of 0.035 percent.

DISCUSSION: The high rates of return earned by lenders for which financial results are publicly available indicate that there continues to be excess lender subsidy in FFEL. There is no reason to relieve lenders of the obligation to pay the fee on the loans that are still so subsidized simply because no special allowance is necessary to deliver the subsidy, or the lender does not have a sufficient number of borrowers still in school or the grace period.

RECOMMENDATION:

- (1) Increase: The lender fee should be increased to ___ percent, and a semiannual holding fee of ___ percent should be imposed.
- (2) Collection: Lender fees should be directly collectible.

c. Interest rate for in-school and grace periods

ISSUE: Should the interest rates be reduced during the in-school and grace periods?

BACKGROUND: Section 427A currently reduces interest rates on subsidized and unsubsidized Stafford loans by 0.60 percent while the student is in school or in a grace period. Compare subsection (g) with subsection (f)(1). The reduction is eliminated for new loans made after July 1, 1998.

DISCUSSION: Since collection activities do not begin until

*Because
of 1
change*

a loan enters the repayment period, lender expenses are at their lowest while the student is in school or in a grace period. Of the various means of reducing excess lender subsidy, the interest rate during these periods is particularly attractive, because of the vulnerability of the level of student subsidy to efforts from time to time to reduce it even if the interest rate is not changed. A reduction in the interest rate during this period would reduce the economic attractiveness of student lending more for lenders that only originate loans than for long-term holders.

RECOMMENDATION: The interest rate on subsidized and unsubsidized Stafford loans should be reduced by __ percent while the student is in school or in a grace period.

d. Secondary Market Fee

ISSUE: Should a new fee be imposed on secondary market holdings of FFEL loans?

BACKGROUND: The President's FY97 budget included a proposal to extend to all secondary markets the current annual offset fee of 0.30 percent paid by Sallie Mae.

DISCUSSION: If the President's proposal is not adopted, the offset fee should at least be extended to all secondary-market holdings funded by tax-exempt financing. Such holdings also have substantial Government-subsidized funding advantages over those of other lenders.

RECOMMENDATION:

- (1) All secondary markets: The 0.30 percent offset fee paid by Sallie Mae should be paid by all other secondary markets.
- (2) Tax-exempt financing: If recommendation (1) is not adopted, the offset fee should be extended to all secondary-market holdings funded with tax-exempt financing.

e. Special allowance

ISSUE: Should the special allowance be altered or repealed?

BACKGROUND: Although lenders are specifically authorized by §427A(j) to set their own interest rates on FFEL loans, the balance of that section has always provided maximums. In the early years of FFEL, the maximums were in fixed terms. They are now floating rates referenced to Government securities with fixed-rate caps. To ensure that the maximums and caps for the benefit of the borrowers did not impede loan access by making voluntary lending by private lenders uneconomic, Congress also enacted §438 to establish a special allowance, by which the Government makes payments to the lenders if the interest paid on the loans is less than a minimum spread over a reference rate for Government securities. The special allowance structure is highly complex. The former reduction in subsection (b)(2)(B) for holdings financed with tax-exempt funds was eliminated in 1993 because the floor established as part of the reduction was actually increasing the Department's costs.

DISCUSSION: When the special allowance was first established, lenders could not obtain protection against the interest rate maximums and caps in the private market. With the growth of derivative securities, however, that is no longer the case. As long as there is a substantial positive spread (probably 50 to 100 basis points) between the cap and the lender's funding rate, the lender can either negotiate an equivalent cap to its own funding or purchase a separate contract to protect itself against the risk. If the spread is too narrow for such protection to be available, the lender can purchase protection at higher levels and/or continue making new loans at temporarily uneconomic spreads to maintain/increase its market share or for other business reasons. If any resulting decrease in available private loan capital causes an access problem, the Secretary can use the tools available for such problems (see p. __, below), particularly Federal advances to lenders and DL. The elimination of special allowances would be highly controversial, would be scored as a saving of only \$__ and raises fundamental questions as to the relationship between FFEL and DL. The subgroup is substantially divided on the question. All members agree, however, that a reduced special allowance is appropriate for new loans financed by tax-exempt funds. There are currently some \$20 billion in such loans outstanding.

RECOMMENDATION:

- (1) Options for repeal
 - (i) Repeal
 - (ii) Leave in effect
- (2) Tax-exempt financing: The special allowance should be halved for new PFEL loans financed with tax-exempt funds. There should be no floor on the reduced payment.

SPECIAL ALLOWANCE PAYMENTS IN THE GUARANTEED STUDENT LOAN PROGRAM

- Special allowance payments are made by the Department to loan holders to protect them from interest risk within a specific time period. The Higher Education Act guarantees loan holders specific interest yields on guaranteed loans; special allowance payments are made when this guaranteed quarterly interest yield is higher than annual student interest payments.
- Special allowance rates are calculated in a three-step process:
 - determine quarterly 91-day Treasury bill rate (e.g., 5 percent).
 - add the statutory interest spread to determine the guaranteed yield level (e.g., 5 percent plus 3.1 percent spread equals 8.1 percent guaranteed yield).
 - subtract student interest rate from the guaranteed yield to determine special allowance rate (e.g., 8.1 percent guaranteed yield minus 7.75 student interest rate equals 0.35 percent special allowance rate.)
- Statutory interest spreads and guaranteed yield levels vary depending on when a loan was made.
 - Most student interest rates are reset annually and have statutory maximum levels. Student interest rates currently equal the 91-day Treasury bill rate plus 3.1 percent, with a maximum level of 8.25 percent. If the 91-day Treasury bill rate plus 3.1 percent is greater than the maximum level, the difference will be paid as special allowance.
 - Some older loans, and all Consolidation Loans, have a variety of fixed lifetime student interest rates. Many of these older loans have been converted to annually reset variable rate loans.
- Because student interest rates are only reset annually, changes in interest rates within a year will cause changes in the guaranteed yield. Special allowance guarantees that loan holders' interest yields increase as interest rates rise. However, there is no mechanism to reduce loan holder yield if interest rates decline below the student interest rates, which act as a yield "floor."
- Special allowance is estimated at less than \$100 million in FY 1997.

November 22, 1996
Budget Service

Ref -

Per our conversation

Q -



Nina Winkler @ ed.gov
11/19/96 10:26:00 AM

Record Type: Record

To: Robert M. Shireman

cc:

Subject: Re[2]: I have a computer! (and a phone)

I think the proposed rules go as far as they can within current legislation and considering the "let's not look like we're trying to actually destroy the ga's" tone of current policy. At that point, the Department's ability and desire to enforce our rules is the biggest limitation. Probing questions about enforcement activities in the past three years might be a fruitful activity for you.

More interesting than the regs are the legislative ideas, which are coming in the budget proposal. These would go much further in turning the agencies into contractor-oids without going through the government procurement system. My humble contribution was expiration dates on GA agreements, plus the right to change the agreements in renegotiation. This innocent little authority gives the secretary almost total control over the agencies. If there is a will to use the authority.

Other good stuff in the legislation includes putting the agencies on a working capital basis, providing a few incentives to cut costs, ditching the cumulative default rate trigger which is so easy to game, and getting the lenders to pay for GA supplemental preclaims assistance.

I would also like to limit originating lender eligibility to financial institutions with other large consumer lending operations. We will propose eliminating insurance companies which have been a source of a lot of consumer complaints. I would go much further, allowing only big consumer lenders, which greatly simplifies oversight and does not limit access. Due diligence rules then melt away into a simple requirement that they service our loans in the same way that they service their own. I also would not let the GAs decide which lenders are in the program--that should be a Federal government call if the GAs are simply a pass through for Federal default reimbursement.

On other rules, the financial responsibility and cash management rules demonstrate what a poor job we do of preparing the way for big changes affecting schools. Both initiatives were partly underway when I came into this job, and out of my personal area of expertise so I've let them unfold in the normal policy process with little involvement. But we need to do much better in using studies, data, and community consultation, in such activities. Last year I asked my deputy, Brian Kerrigan, and Jeff Baker, the Policy Division director, to interview our internal customers (including Pat Smith), to get their ideas about

future regulatory initiatives. That was a big improvement over our more secretive past. But I think we need to beef up that planning process a lot more. You may also wish to participate in a planning meeting in this area.

I'll try to remember to let you know as interesting things happen--but feel free to call or write with questions, as it is sometimes hard for me to think of what you would like to know. (My direct line is 401-0993).

Nina

Reply Separator

Subject: Re: I have a computer! (and a phone)

Author: "Robert_M._Shireman"@oa.eop.gov at Internet

Date: 11/18/96 9:16 PM

Message Creation Date was at 18-NOV-1996 21:16:00

When we last talked, you offered to be an inside source, and I could definitely use that. Feed me any information. Tell me what you think of things. For example, what do you think of the G.A. regs as they are being finalized?

Discussion: As has been made clear in the NPRM and in responses to comments in this preamble section, the Secretary is not regulating how a guarantor handles its non-FFEL assets or funds. On the other hand, the Secretary fully intends to take steps to protect the Federal reserve fund. Accordingly, guarantor contracts with other parties that require the use of Federal reserve funds or assets are subject to the 30-day notification requirement.

Changes: None

who?

Comment: One commenter from a guaranty agency agreed that the Secretary ~~should~~ actively seek to prevent improper depletion of the reserve fund, but considered the Secretary's proposed regulations to be inadequate for that purpose. In the commenter's judgment, the protection of reserve funds cannot be achieved merely by prohibiting a limited number of specific types of expenditures which, in the aggregate, represent an insignificant share of overall guaranty agency costs. Instead, the commenter recommended that the Secretary focus on the relative cost effectiveness of individual guarantors in carrying out their primary responsibilities under the HEA. The commenter suggested an alternative approach that would enable the Secretary to focus on whether proper value is being received for reserve funds expended. The commenter additionally stated that the alternative approach would avoid what the commenter viewed to be "inevitable, tedious, and diversionary arguments" that the measures proposed by the Secretary to restrict specific types of

expenditures are punitive in nature, represent micromanagement, and are designed to hamper the ability of guarantors to effectively compete with the Direct Lending Program. The commenter recommended that the regulations be revised to accomplish (1) the expansion of the Secretary's current guarantor evaluation model to provide a "fully loaded" (all overhead costs allocated) analysis of each guarantor's unit costs of delivering its services; (2) on-going monitoring of each guarantor's performance relative to the model through requiring Part E 1130 data to be submitted quarterly rather than annually; (3) establishment of maximum acceptable unit cost standards for each primary guarantor service (e.g., 125 percent of national mean cost); (4) the identification and correction of specific factors that result in a guaranty agency exceeding the acceptable unit costs in one or more areas; (5) requiring a guaranty agency to take corrective action where overall costs exceed current revenues (exclusive of investment income); and (6) a targeted program review effort designed to ensure that acceptable unit costs are not being achieved at the expense of program integrity. The commenter believed that under the alternative approach, guaranty agencies that manage their operations in a cost-effective manner would be able to exercise management discretion and flexibility, which may well be a major factor in realizing that outcome, and that the alternative approach would be consistent with the Secretary's recent initiatives to provide

incentives for work well done and to encourage common sense and good business practices by guarantors.

Discussion: Although the commenter has presented an interesting proposal, the Secretary must decline to pursue it as an alternative to fiduciary standards. As long as a guaranty agency holds Federal funds, the Secretary believes it is appropriate to hold the agency accountable under those standards.

Changes: None.

Comment: One commenter thought that all of the prohibitions and limitations in §682.418(b) were unnecessary because the Secretary could simply rely on the definition of "reasonable cost" found in §682.410(a)(11)(iii). Thus, for example, contributions and donations would only be prohibited to the extent that they were not reasonable.

Discussion: The commenter's proposal ignores the limited purpose of the Federal reserve fund and assets. Those funds and assets are provided solely to serve FFEL Program purposes. The Secretary has determined that certain uses of those funds and assets are simply unreasonable, in light of their intended purpose.

Changes: None.

Comment: Some commenters objected to the restrictions against advertising in §682.418(b)(1) and recommended that a guaranty agency should be permitted to use reserve funds to advertise the types of services that the agency provides. The commenters mentioned many types of services, including default prevention

Issue Paper --
Department of Education
(In millions of dollars)

ISSUE: Student loans (Federal Family Education Loans and Federal Direct Student Loans)

	<u>FY 1998</u>	<u>FY 1999</u>	<u>FY 2000</u>	<u>FY 2001</u>	<u>FY 2002</u>	<u>Total</u>
Midsession Baseline OL..... (Subject to new economics and technicals)	2,898	3,052	3,269	3,469	3,681	16,117

Option 1:

FY 1997 Budget, revised.	-1,046	-519	-486	-486	-495	-3,031
--------------------------	--------	------	------	------	------	--------

Note: these savings are being carried in the preliminary FY 1998 Budget plan.

Option 2:

Agency request	-2,653	9	73	80	81	-2,411
----------------	--------	---	----	----	----	--------

The agency request is to reduce borrower fees, lender yield, and Federal administrative costs, require lenders to offer income-contingent repayment and pay for loan amounts not repaid, and restructure guaranty agencies. **Caveat:** ED's proposed savings include the savings in option 1. If those savings are assumed to be already part of Administration policy, ED's proposal costs \$.6 billion.

Option 3:

PAD alternative	-2,821	-285	-231	-237	-253	-3,827
-----------------	--------	------	------	------	------	--------

Reduce borrower fees by a lesser amount. Reduce lender yield and Federal administrative costs as in option 1. Replace guaranty agencies with contractors in the guaranteed program.

DESCRIPTION OF ISSUE: In 1993, the President proposed to “scrap” the guaranteed student loan system and replace it with one that was simpler for schools and families, cheaper for taxpayers, and offered students the option of paying off their loans as a small percentage of their income after they graduate. Congress, in the 1993 reconciliation bill, provided for a partial phase-in of the new Direct Student Loan Program, but punted on the question of the ultimate fate of the guarantee system (the Federal Family Education Loan Program, or FFELP). During the negotiations over the final bill, Secretary Riley expressed concern that in failing to completely reform the system, the lenders and guaranty agencies would keep coming back and could even undermine direct lending.

When the Republicans took over Congress after the 1994 election, the Direct Loan Program was still in its infancy, with only five percent of total loan volume. But the schools and students were thrilled with the improvements that the new system offered. In order to protect the program from elimination or caps, the Administration shifted from a policy that assumed a phase-out of FFEL, to one that promoted competition -- allowing schools to decide which program they want to deliver loans to students at their institutions. Students do not have a choice, except that they can consolidate their FFEL loans in to direct lending if their lender does not offer a satisfactory repayment plan.

Despite the controversy in Congress, the Direct Loan Program grew to ___ percent of loan volume in its second year, 1995-96. That was below the target of 40 percent, but the same as the phase-in target that the President had originally proposed. While the rave reviews of the program continued, this year it grew to only 35 percent (and most of the new volume is small trade schools).

There are three primary reasons that growth of the Direct Loan Program has slowed. First, in a “choice” environment, the ones who most wanted to leave FFEL did so in the first and second year. For the many schools that had been toying with the idea of entering the program’s third year, the debate in Congress prompted them to sit tight. Second, competition from direct lending has improved the guarantee program. As a result, many institutions support the continuation of both programs in order to continue the trend of improvements in the bank-based program and the quality of direct lending.

Finally, for the first time in the 30-year history of the guarantee program, some of the participants have discovered price competition, albeit of a different brand. As a sweetener to schools that stay in FFEL, some guaranty agencies have offered to forego the one percent “insurance premium” that they charge students (and which goes into the Federal reserve fund). At the same time, they lobby Congress for an appropriations earmark (out of the mandatory account set up for direct lending). So, they are essentially using Federal money to provide a financial incentive for students and schools to stay in FFEL. Some lenders and secondary markets -- particularly Sallie Mae -- have also begun to offer deals to students, a sign that there continue to be excess profits in the system.

While competition has improved the FFEL system for schools, the management challenge for the Federal government has remained unchanged. Lenders and secondary markets are protected against default risks and interest rate risks, so assuring due

diligence in collection requires detailed regulations and extensive back-end monitoring. State-based guaranty agencies were originally created to do the monitoring **and to share the risk**. But when only a few states made the financial commitment, Congress in 1976 assumed virtually all of the costs, but still required a network of guaranty agencies to help administer the program. That structure, combined with a Congressionally-set payment system that bears no relation to actual costs,¹ led GAO (1993) to conclude that the Education Department “lacks sufficient leverage over guaranty agencies to achieve effective financial management and adequate program control.” The agencies’ connections to governors and key decision makers in Congress have made it difficult to change that structure.

There will be two opportunities to propose changes to the student loan programs in the coming Congress. Proposals with budget implications can be part of a reconciliation bill. Second, Congress will reauthorize the Higher Education Act this year, opening up broader student aid issues, including loans. The Education Department plans to submit a proposal for reauthorization in April. (The Chairman of the House authorizing committee has asked for all input by January, and plans to finish by _____ -- . This time line is probably an attempt to ensure that he has his say in the reconciliation process).

DISCUSSION:

Option 1 (1997 Budget) imposes various fees and reduces subsidies to lenders, guaranty agencies, and secondary markets. Other than taking back a portion of the reserve funds, it does not change the basic structure of FFEL, nor does it address the problem of differential fees in the direct versus guarantee system. The five-year savings total \$3 billion, which is currently built in to the baseline.

The Education Department (Option 2) proposes the maximum reductions in subsidies to lenders, secondary markets, and guaranty agencies that they believe are possible in the FFEL program, including a restructuring of guaranty agencies that makes possible the return of almost all Federal reserve funds held by these agencies. ED proposes to use these savings to offset reductions in borrower fees in the direct and guaranteed programs in order to reduce the debt burden on borrowers, and improve the competitive position of direct lending. The five-year savings would total \$2.4 billion, putting the budget \$600 million above baseline.

¹Aggregate guaranty agency revenues (totaling an estimated \$800 million in FY 1997) are derived from borrower insurance premiums, Federal administrative cost allowances (based on .85% of new loan volume), investment income from Federal reserves (an estimated \$1.8 billion at the end of FY 1995), a 27% bounty on collections on defaulted loans, and payments for pre-claims assistance.

ED's restructuring proposal calls for guaranty agency agreements to expire periodically, and would eliminate their now-irrelevant statutory guaranty function, thereby making it possible to call back most of their liquid reserves -- almost \$2 billion -- which would be scored as receipts to offset other costs. The agencies would be paid based on the size of their portfolio, as well as a new lender-paid "default prevention" fee, to move the focus to prevention instead of default collection.

The PAD recommendation (Option 3) rejects the use of statutory formulas for paying for program administration. Instead, it would rely on performance-based Federal contracts to perform those essential functions now carried out by guaranty agencies. The PAD recommendation includes some reductions in fees for all borrowers in both programs, which can be offset by a new reduction in lender return proposed by ED and the call back of the reserve funds. The five-year savings would total \$3.8 billion, or about \$800 million below baseline.

[PAT: I DON'T UNDERSTAND THIS NEW STUFF FROM THE DEPARTMENT. LET'S DISCUSS THESE TWO PARAGRAPHS]

To make the savings needed to cover much of the fee reduction and address Congressional concerns for a "level-playing field" between the two programs, ED recommends requiring lenders to offer the same repayment plans available in the direct loan program, including income-contingent repayment, and the borrowers' option to change plans as often as they choose. By requiring lenders to absorb the losses associated with income-contingent repayment, and loan cancellation after 25 years, ED estimates another \$1.1 billion in savings over FY 1998-2002, and \$.3 billion in 2002.

ED's rationale for its dramatic reduction in fees: In the light of the benefits that middle-income students would receive from Hope Scholarships, ED recommends eliminating the origination fee altogether for students receiving Stafford loans in both programs (which provides in-school interest subsidy to those demonstrating need). This adds \$1.7 billion to cost in the FY97 budget over FY 1998-2002, and \$.6 billion in 2002.

SCORING ISSUES: Two provisions with of the Federal Credit Reform Act (FCRA) have major policy implications on the cost in this program, and savings that can be achieved by the direct loan program.

(1) Administrative funds: Under the FCRA, Federal administrative costs (including servicing) in the direct loan program are determined on an annual cash basis, while bank-servicing in the guarantee program is covered partly by borrowers, and partly in the subsidy on a net present value basis. Federal administrative cost allowances to GAs are charged to the direct loan program's funding authority for student loan administrative funds. Because the Budget and authorizing committees felt that the budget rules gave direct lending an unfair advantage, the Budget Resolutions in FY 1996 and 1997 required CBO to use a baseline including Federal

administrative costs for the direct student loan program. (Whether or not the change was warranted, there is evidence that CBO did not apply it fairly).

The question of how to budget Federal administrative (particularly servicing) costs in credit programs to achieve greater cost effectiveness is under discussion in OMB since the Review on Credit Reform.

Under current law and with current interest rates, the direct loan subsidy rate is about 9 points higher than that of the FFELP [PAT, THAT MUST BE REVERSED, YES?]. Adding Federal administrative costs to the direct loan subsidy rate increases the rate by approximately 7 points. If, in addition, the reductions to FFELP subsidies proposed in this paper were enacted, ED projects that the subsidy rate for the two programs would be approximately the same, with direct lending possibly a little higher, depending on interest rate projections. CBO projections could be worse, or better, for direct lending.

But there is another wrinkle. . .

(2) Discount rate: A major driver of the subsidy rate in the direct loan program is the discount rate. In estimating net present values, the FCRA calls for the discount rate to be “the average interest rate on marketable Treasury securities of *similar maturity* to the direct loan or loan guarantee.” For the student loan programs, OMB and CBO currently use the average of a 10-year to 20-year Treasury bond. Borrowers in both loan programs currently pay a variable interest rate. Some have argued that a variable rate loan reaches “maturity” each time it varies (every year, in the case of student loans). Indeed, Sallie Mae finances its lending primarily through short-term securities, both because borrower interest changes annually (up to a cap), and because the Federal government protects it from interest fluctuation every quarter. The assumption that the Federal cost-of-borrowing is the higher, longer-term rate considerably reduces the NPV of income from future payments on direct student loans, and reduces the NPV of cash default payments in the guarantee program. In other words, the savings associated with direct lending would be much larger -- even with servicing costs incorporated in the subsidy -- if the shorter-term discount rate were used.

[PAT: THE CHANGE TO THE 10-YEAR BOND FOR SETTING THE LOAN RATE IS NOT RELEVANT TO THIS DISCUSSION BECAUSE IT STILL VARIES ANNUALLY OR QUARTERLY, SO IT’S REALLY STILL A SHORT-TERM RATE. YES?]

This issue has been the subject of intense discussion within OMB, and with Education, Treasury and CBO. There are at present strong differences of opinion. Because of the large impact this rate makes on the cost of the direct student loan program, we recommend that these discussions on government-wide policy on this issue be resumed, including legislative change if appropriate.

DESCRIPTION OF OPTIONS:

Option 1: The President's 1997 Budget proposed savings: \$3 billion over FY 1998-2002, and \$.5 billion in FY 2002. This proposal would reduce subsidies to lenders, secondary markets, and guaranty agencies (GAs), and reduce Federal administrative expenses. It was not enacted. Proposed reductions in subsidies to lenders and secondary markets totaled \$1.2 billion (increasing a new loan holder fee, increasing the lender origination fee, reducing lender insurance from 98% to 95%, requiring all secondary markets to pay the same offset fee charged to SLMA on new loan purchases for the life of the loan); reductions in payments to guaranty agencies of \$.7 billion (reducing guaranty agency reinsurance and default collection retention, eliminating guaranty agency pre-claims assistance); and recall of \$600 million in GA reserves.

Further, the Budget proposed a reduction in Federal administrative costs of \$.5 billion over FY 1998-2002. In the Student Loan Reform Act of 1993, sec. 458 provided mandatory authority for administrative costs for FY 1994-1998. ED has projected a baseline for FY 1999-2002 consistent with funding in the statute for the earlier years, which had assumed moving to 100% direct lending, and experience has indicated that savings can be achieved allowing reductions in that baseline.

Option 2: Agency request savings: - \$2.4 billion for FY 1998-2002, and \$-.1 billion in 2002.

(1) Reducing borrower fees. Cost: \$3.3 billion for FY 1998-2002, and \$.8 billion in 2002. In the Direct Loan program, the borrower pays an origination fee of 4% of the loan amount to offset Federal costs. In the guaranteed loan program, the borrower pays an origination fee of 3%, and in addition, the guaranty agency (GA) has the option of charging the borrower an "insurance premium" of not more than 1% . ED proposes --

- to eliminate the 1% insurance premium that a guaranty agency may require all FFELP borrowers to pay [no cost],
- to reduce the origination fee for borrowers in the Direct Loan program from 4% to 3% [cost: \$.9 billion], and
- to eliminate the remaining 3% borrower origination fee in both programs only for all "subsidized" borrowers, that is, needy students, whose in-school interest is subsidized [cost: \$2.5 billion].

(2) Restructuring guaranty agencies. Savings: -\$1.5 billion over FY 1998-2002, and -\$0.2 billion in 2002. ED proposes to change the guarantor function, and achieve savings by requiring the return of \$2 billion in reserve funds. ED proposes to eliminate the current statutory annual cap of \$2 billion on the volume of loans that the Federal government can guarantee loans directly. The 1992 Amendments to the Higher Education Act clarified that the Federal government is the guarantor in the event of guaranty agency insolvency. ED is not prepared to replace GAs with contractors for the operation of the FFELP, but proposes that the Secretary continue to designate them, requiring their periodic recertification. Under ED's proposal GAs would retain enough reserves to pay lender claims until they are reimbursed by ED (\$300 million), and to pay 6 months of operating costs (\$100 million). In addition to

the investment income from these remaining reserves, ED proposes to compensate GAs approximately \$300 million annually through (a) an annual administrative cost allowance based on a percentage of new loans guaranteed, and (b) a per-loan "operations fee" based on total portfolio, budgeting these expenses on a present value basis as part of the subsidy rate, rather than budgeting them on a cash basis. Lenders would pay GAs a default prevention fee.

These savings do not represent a substantial increase over the savings in the FY 1997 Budget, but ED proposes a quite different way of achieving them. Savings in the new proposal (from recalling most of the GAs liquid reserves) were partially achieved in last year's budget by reducing the reinsurance of default claims paid by ED to GAs.

(3) Reducing return to lenders. Savings: -\$3.8 billion over FY 1998-2002, and -.8 in 2002. ED proposes to reduce lenders' return while the student is in school to the rate at which ED borrows from Treasury, reduce lender insurance from 98% to 90%, extend the .3% Sallie Mae fee on loans it holds to other secondary markets, increase the lender origination fee from .5% to .8%, create a new loan holder fee, and require lenders to offer the same repayment options as ED does in the direct loan program, including income-contingent repayment, under which the banks would have to absorb loan costs not repaid in the maximum 25-year repayment period. These were part of the 1997 Budget except for the reduction in the return to the lender during the in-school period, and requiring lenders to offer the same repayment options as the direct loan program. ED also proposes to standardize the terms and conditions of consolidated loans in both programs and require that lenders in the FFELP that offer discounts offer them to all borrowers (no "creaming").

(4) Reduce Federal administrative costs. Savings: -.5 billion over FY 1998-2002, and -\$1 billion in 2002. [Same as option 1] In the Student Loan Reform Act of 1993, sec. 458 provided mandatory authority for administrative costs for FY 1994- 1998. ED has projected a baseline for FY 1999-2002 consistent with the estimates in the statute for the earlier years, which had assumed moving to 100% direct lending, and experience has indicated that savings can be achieved allowing reductions in that baseline.

Option 3: PAD alternative savings: -\$3.8 billion

(1) Reduce borrower fees in direct lending in order to equalize student cost in both programs, but do not lower them even further. Cost: \$.9 billion. Eliminate the 1% insurance premium that guaranty agency may, but sometimes do not, require all FFELP borrowers to pay [no cost], and reduce the origination fee for all borrowers in the Direct Loan program from 4% to 3% [cost: \$.9 billion]. Students in both programs would therefore pay a 3% origination fee.

(2) Terminate GAs and award performance-based Federal contracts to accomplish the record-keeping, claims payment, default prevention and default collection functions. Savings: -\$1.5 billion. This option does not specify greater savings than ED's proposed restructuring of GAs. ED estimates that it will cost approximately \$300 million per year in Federal funds to finance these GA functions under their restructuring proposal. Because of ED's inadequate data on realistic costs for these functions, it is not possible to estimate specific additional savings, but we believe they could be substantial if done under Federal performance-based contracts. The number of contractors needed would be much fewer than the 38 GAs now operating. There would be no need for working capital to provide float during the period that GAs have not been reimbursed by ED for default claims. Lenders could submit claims directly to ED. The competitive bidding process would result in lower unit costs than ED's proposal, which proposes a per-loan fee based on current GA expenditures, and continuation of the cost allowance based on a percentage of new loan volume. Nonperforming contractors could be terminated with substantially less political controversy than a State agency or non-profit organization having a designation by the Secretary.

(3) Reduce return to lenders. Savings: -\$2.8 billion. This package would be the same as option 1, except that it does not propose requiring lenders to offer income-contingent repayment. It does include the additional proposal to reduce the return to the lender during the in-school period, which was not part of the FY 1997 Budget package.

(4) Reduce Federal administrative costs. Savings: -\$5 billion over FY 1998-2002, and -\$1 billion in 2002. [Same as options 1 and 2]

RECOMMENDATION: Option 3. Either proposal for restructuring FFEL -- contracting for the essential functions performed by GAs, or shifting the incentive and payment structure of the current system -- will be opposed in Congress by supporters of the guaranteed loan program. Proposing performance-based, competitive contracts is a straightforward statement of how best to achieve effective cost control and program integrity. A more detailed review is needed of potential savings that could be realized.

It should be noted that the Education Department does not feel that the procurement process provides the kind of control that is needed to administer FFEL effectively. The Department may strongly object to this approach.

[PAT: WE HAVE TO DISCUSS THE NEW STUFF IN THESE FINAL PARAGRAPHS]

While it would be desirable to eliminate borrower up-front fees, and have the borrower's interest payments in the direct loan program cover Federal costs, but we have not identified appropriate offsets for reducing costs to borrowers (whether from fees or interest), and there are unresolved issues regarding how accurately current Federal scoring represents Federal costs in both programs, but particularly in the direct loan program.

It is not realistic for the Federal government to attempt to require banks and secondary markets to offer income-contingent repayment and cancellation of payments after 25 years, and to estimate substantial savings. Banks have resisted all efforts to liberalize repayment options to borrowers across-the-board. The direct student loan program can offer continue income-contingent repayment through loan "consolidation" into the direct loan program even to borrowers who have a guaranteed loan.

A remaining Federal cost issue in both programs is default losses, which will require reconsideration of student and institutional eligibility requirements and standards as well as Federal management. As part of the larger reauthorization package, consideration will be given to institutional performance standards as a supplement to or replacement for the default rate "kick-out" provision in identifying schools whose poor performance results in excessive Federal costs and program abuse, by making many needy students who attempt postsecondary education worse off by having assumed debt and not having bettered their economic circumstances.

frequency
- 2R mod eR. 26
frequency

\$ 988 million
off

\$2 billion
- 100% of 100%

phase 1

the code will 2000/2001

- 100% Δ: 640 million,
but 216 is double-rumped
→ 1.3 billion

frequency on 0.5%
frequency on 0.5%

NOT (CL)

PREPARER/EXT: Pat Smith/5-5882

Exhibit 7

Issue Paper --
Department of Education
(In millions of dollars)

ISSUE: Student loans (Federal Family Education Loans and Federal Direct Student Loans)

	<u>FY 1998</u>	<u>FY 1999</u>	<u>FY 2000</u>	<u>FY 2001</u>	<u>FY 2002</u>	<u>Total</u>
Midsession Baseline OL..... (Subject to new economics and technicals)	2,898	3,052	3,269	3,469	3,681	16,117

Option 1:

Savings proposed in FY 1997 Budget, revised.

Note: these savings are being carried in the preliminary FY 1998 Budget plan.

-1,046	-519	-486	-486	-495	-3,031
--------	------	------	------	------	--------

Option 2:

Agency request	-2,653	9	73	80	81	-2,411
----------------	--------	---	----	----	----	--------

The agency request is to reduce borrower fees, lender yield, and Federal administrative costs, require lenders to offer income-contingent repayment and pay for loan amounts not repaid, and restructure guaranty agencies. **Caveat:** ED's proposed savings include the savings in option 1. If those savings are assumed to be already part of Administration policy, ED's proposal costs \$.6 billion.

Option 3:

PAD alternative	-2,821	-285	-231	-237	-253	-3,827
-----------------	--------	------	------	------	------	--------

Reduce borrower fees by a lesser amount. Reduce lender yield and Federal administrative costs as in option 1. Replace guaranty agencies with contractors in the guaranteed program.

DESCRIPTION OF ISSUE: The President proposed in 1993 to replace the guaranteed student loan program (Federal Family Education Loan Program, or FFELP) with the less expensive direct student loan program, providing more flexible repayment options, including income-contingent repayment. ^{Congress, in the 1993 reauthorization bill,} ~~The Student Loan Reform Act of 1993~~ provided a phase-in of direct lending, but was silent on full replacement of guaranteed lending, deferring the issue to the next Higher Education Act reauthorization (CY1997/98). During the battles with the Republican majority after the 1994 election, the Administration shifted to a policy of allowing competition between the two programs, leaving the choice to the institutions (not the students).

Even though the direct loan program ^{schools choose the d.l. program now represent about} has been universally praised by participating institutions, ED ^{while} has not achieved the goals specified in the statute for loan volume; ^{what are at least two reasons for this?} currently 35% of total loan volume is in the direct program, though the goal for academic year 1996/97 is 50%. ~~This may at least partly reflect institutional uncertainty regarding the future of the program because of repeated Congressional assaults during 1996 and 1997, but the improvements made by the lenders and guaranty agencies, fighting for their profits by improving service to institutions and borrowers, are also responsible.~~ ^{Second} Competition from direct lending has improved the guaranteed program, ^{as a result} and many institutions participating in the guaranteed program support the continuation of both programs in order to continue the trend of improvements in the bank-based program. ^{schools are competing for market share} In competing for market share, however, banks and guaranty agencies have greater flexibility in adjusting their fees and interest rates than the Federal government, and ED has been at a disadvantage when reductions were implemented by the players in the guaranteed program. ED wants to reduce borrower fees to make loans cheaper for students and equalize terms in the two programs. ^{signs of excess profits, at a g.d. case}

^{more force} Further, the guaranteed loan program presents ongoing management problems -- as discussed at the Education Review -- particularly regarding the performance of the guaranty agencies in integrity of financial data, cost control, and default prevention. Aggregate agency revenues (totalling an estimated \$800 million in FY 1997) are derived from borrower insurance premiums, Federal administrative cost allowances (based on .85% of new loan volume) that bear no relationship to actual costs, investment income from Federal reserves, and 27% of collections on defaulted loans, which they receive regardless of actual costs. ED estimates that this income significantly exceeds costs; consequently reserves increase each year, and there are no effective controls on how the agencies spend these funds. As long as guaranty agencies exist, with their financial incentives and ED's lack of leverage over them, it is unlikely that the underlying problems will be solved.

These three options are primarily budget-driven. ED plans to submit a full-scale reauthorization of the Higher Education Act by next April.

ARKS for a small savings:

i app

RRS

in-scheme i (Gaffard)

\$ Leaks for savings: ^{for ED}

Leakage:

S-M.

DISCUSSION: The agency proposes the maximum reductions in subsidies to lenders, secondary markets, and guaranty agencies (GAs) that they believe are possible in the FFEL program, including a restructuring of GAs that makes possible the return of almost all Federal reserve funds held by these agencies. They believe that further reductions to lenders would jeopardize access to capital in that program. They propose to use these savings to offset reductions in borrower fees in the direct and guaranteed programs in order to reduce the debt burden on borrowers, and improve the competitive position of direct lending. These proposed savings would not be sufficient to offset this reduction: \$3 billion in savings proposed by ED were included in the FY 1997 Budget and are assumed to be already part of the 1998 adjusted baseline, and even if they could use these savings to offset their proposal, there would be a shortfall of \$.6 billion.

To achieve slightly greater savings than that proposed in FY 1997, and increase its leverage over the GAs, ED proposes to restructure the GA's: require them to be recertified periodically; and eliminate their now irrelevant statutory guaranty function, thereby making it possible to call back most of their liquid reserves -- almost \$2 billion -- which would be scored as receipts to offset other costs. The PAD recommendation would go further in addressing the management problems in the current system as well as making savings by replacing the guaranty agencies with Federal contractors.

The PAD recommendation includes some reductions in fees for all borrowers in both programs, which can be offset by a new reduction in lender return proposed by ED, but we believe that the total fee reductions proposed by ED cannot be realistically financed as proposed.

To make the savings needed to cover much of the fee reduction and address Congressional concerns for a "level-playing field" between the two programs, ED recommends requiring lenders to offer the same repayment plans available in the direct loan program, including income-contingent repayment, and the borrowers' option to change plans as often as they choose. By requiring lenders to absorb the losses associated with income-contingent repayment, and loan cancellation after 25 years, ED estimates another \$1.1 billion in savings over FY 1998-2002, and \$.3 billion in 2002.

ED's rationale for its dramatic reduction in fees: In the light of the benefits that middle-income students would receive from Hope Scholarships, ED recommends eliminating the origination fee altogether for students receiving Stafford loans in both programs (which provides in-school interest subsidy to those demonstrating need). This adds \$1.7 billion to cost in the FY97 budget over FY 1998-2002, and \$.6 billion in 2002.

SCORING ISSUES: Two provisions with of the Federal Credit Reform Act (FCRA) have major policy implications on the cost in this program, and savings that can be achieved by the direct loan program.

new: 6.11 + 1 = 7.11
1.72 + 3.1 = 4.82
7.89
7.24 4.22 4.25

(1) Administrative funds: Intense debates with Congress have taken place in the budget/appropriations process regarding comparative Federal program costs and subsidy rates for the two student loan programs because of the requirement in the FCRA to budget Federal administrative costs on an annual cash basis. In contrast, lenders' administrative costs in the FFELP are paid by the borrower, Federal interest payments to lenders over the life of the loan, and Federal administrative cost allowances to GAs charged to the direct loan program's funding authority for student loan administrative funds.

The Budget Resolutions in FY 1996 and 1997 required CBO to use a baseline including Federal administrative costs for the direct student loan program, but not the FFELP; the budget and authorizing committees believed the scoring under the FCRA to give direct lending an unfair advantage. Under current law and with current interest rates, the direct loan subsidy rate is about 9 points higher than that of the FFELP. If Federal administrative costs were included in the subsidy rate for both student loan programs, and the reductions to FFELP subsidies proposed in this paper were enacted, the subsidy rate for the two programs would be approximately the same, with direct lending possibly a little higher, depending on interest rate projections. Adding Federal administrative costs to the direct loan subsidy rate increases the rate by approximately 7 points. This scoring issue will be part of the reauthorization debate.

The question of how to budget Federal administrative (particularly servicing) costs in credit programs to achieve greater cost effectiveness is under discussion in OMB since the Review on Credit Reform.

(2) Discount rate: A major driver of the subsidy rate in the direct loan program is the discount rate. In estimating net present values, the FCRA calls for the discount rate to be "the average interest rate on marketable Treasury securities of *similar maturity* to the direct loan or loan guarantee." For the student loan programs, OMB and CBO currently use the average of a 10-year to 20-year Treasury bond. Borrowers in both loan programs currently pay a variable interest rate. Some have argued that a variable rate loan reaches "maturity" each time it varies (every year, in the case of student loans). Indeed, Sallie Mae finances its lending primarily through short-term securities, both because borrower interest changes annually (up to a cap), and because the Federal government protects it from interest fluctuation every quarter. The assumption that the Federal cost-of-borrowing is the longer-term rate considerably reduces the NPV of income from future payments on direct student loans, and reduces the NPV of cash default payments in the guarantee program. The impact is much larger in the direct loan program.

Beginning in FY 1998, under current law, the borrower in both student loan programs will be charged the rate of "a security of similar maturity" plus 1%, adjusted annually, not to exceed 8.25%.

This issue has been the subject of intense discussion within OMB, and with Education, Treasury and CBO. There are at present strong differences of opinion. Because of the large impact this rate makes on the cost of the direct student loan program, we recommend that these discussions on government-wide policy on this issue be resumed, including legislative change if appropriate.

DESCRIPTION OF OPTIONS:

Option 1: The President's 1997 Budget proposed savings: \$3 billion over FY 1998-2002, and \$.5 billion in FY 2002. This proposal would reduce subsidies to lenders, secondary markets, and guarantee agencies (GAs), and reduce Federal administrative expenses. It was not enacted. Proposed reductions in subsidies to lenders and secondary markets totalled \$1.2 billion (increasing a new loan holder fee, increasing the lender origination fee, reducing lender insurance from 98% to 95%, requiring all secondary markets to pay the same offset fee charged to SLMA on new loan purchases for the life of the loan); reductions in payments to guaranty agencies of \$.7 billion (reducing guaranty agency reinsurance and default collection retention, eliminating guaranty agency pre-claims assistance); and recall of \$600 million in GA reserves.

Further, the Budget proposed a reduction in Federal administrative costs of \$.5 billion over FY 1998-2002. In the Student Loan Reform Act of 1993, sec. 458 provided mandatory authority for administrative costs for FY 1994-1998. ED has projected a baseline for FY 1999-2002 consistent with funding in the statute for the earlier years, which had assumed moving to 100% direct lending, and experience has indicated that savings can be achieved allowing reductions in that baseline.

Option 2: Agency request savings: - \$2.4 billion for FY 1998-2002, and \$-.1 billion in 2002.

(1) **Reducing borrower fees. Cost: \$3.3 billion for FY 1998-2002, and \$.8 billion in 2002.** In the Direct Loan program, the borrower pays an origination fee of 4% of the loan amount to offset Federal costs. In the guaranteed loan program, the borrower pays an origination fee of 3%, and in addition, the guaranty agency (GA) has the option of charging the borrower an "insurance premium" of not more than 1% . ED proposes --

- to eliminate the 1% insurance premium that a guaranty agency may require all FFELP borrowers to pay [no cost],
- to reduce the origination fee for borrowers in the Direct Loan program from 4% to 3% [cost: \$.9 billion], and
- to eliminate the remaining 3% borrower origination fee in both programs only for all "subsidized" borrowers, that is, needy students, whose in-school interest is subsidized [cost: \$2.5 billion].

(2) **Restructuring guaranty agencies. Savings: -\$1.5 billion over FY 1998-2002, and -\$.2 billion in 2002.** ED proposes to change the guarantor function, and achieve savings by requiring the return of \$2 billion in reserve funds. ED proposes to eliminate the current statutory annual cap of \$2 billion on the volume of loans that the Federal government can guarantee loans directly. The 1992 Amendments to the Higher Education Act clarified that the Federal government is the guarantor in the event of guaranty agency insolvency. ED is not prepared to replace GAs with contractors for the operation of the FFELP, but proposes that the Secretary continue to designate them, requiring their periodic recertification. Under ED's proposal GAs would retain enough reserves to pay lender claims until they are reimbursed by ED (\$300 million), and to pay 6 months of operating costs (\$100 million). In addition to

the investment income from these remaining reserves, ED proposes to compensate GAs approximately \$300 million annually through (a) an annual administrative cost allowance based on a percentage of new loans guaranteed, and (b) a per-loan "operations fee" based on total portfolio, budgeting these expenses on a present value basis as part of the subsidy rate, rather than budgeting them on a cash basis. Lenders would pay GAs a default prevention fee.

These savings do not represent a substantial increase over the savings in the FY 1997 Budget, but ED proposes a quite different way of achieving them. Savings in the new proposal (from recalling most of the GAs liquid reserves) were partially achieved in last year's budget by reducing the reinsurance of default claims paid by ED to GAs.

(3) Reducing return to lenders. Savings: -\$3.8 billion over FY 1998-2002, and -\$1.8 in 2002. ED proposes to reduce lenders' return while the student is in school to the rate at which ED borrows from Treasury, reduce lender insurance from 98% to 90%, extend the .3% Sallie Mae fee on loans it holds to other secondary markets, increase the lender origination fee from .5% to .8%, create a new loan holder fee, and require lenders to offer the same repayment options as ED does in the direct loan program, including income-contingent repayment, under which the banks would have to absorb loan costs not repaid in the maximum 25-year repayment period. These were part of the 1997 Budget except for the reduction in the return to the lender during the in-school period, and requiring lenders to offer the same repayment options as the direct loan program. ED also proposes to standardize the terms and conditions of consolidated loans in both programs and require that lenders in the FFELP that offer discounts offer them to all borrowers (no "creaming").

(4) Reduce Federal administrative costs. Savings: -\$1.5 billion over FY 1998-2002, and -\$1 billion in 2002. [Same as option 1] In the Student Loan Reform Act of 1993, sec. 458 provided mandatory authority for administrative costs for FY 1994- 1998. ED has projected a baseline for FY 1999-2002 consistent with the estimates in the statute for the earlier years, which had assumed moving to 100% direct lending, and experience has indicated that savings can be achieved allowing reductions in that baseline.

Option 3: PAD alternative savings: -\$3.8 billion

(1) Reduce borrower fees in direct lending in order to equalize student cost in both programs, but do not lower them even further. Cost: \$.9 billion. Eliminate the 1% insurance premium that guaranty agency may, but sometimes do not, require all FFELP borrowers to pay [no cost], and reduce the origination fee for all borrowers in the Direct Loan program from 4% to 3% [cost: \$.9 billion]. Students in both programs would therefore pay a 3% origination fee.

(2) Terminate GAs and award performance-based Federal contracts to accomplish the record-keeping, claims payment, default prevention and default collection functions. Savings: -\$1.5 billion. This option does not specify greater savings than ED's proposed restructuring of GAs. ED estimates that it will cost approximately \$300 million per year in Federal funds to finance these GA functions under their restructuring proposal. Because of ED's inadequate data on realistic costs for these functions, it is not possible to estimate specific additional savings, but we believe they could be substantial if done under Federal performance-based contracts. The number of contractors needed would be much fewer than the 38 GAs now operating. There would be no need for working capital to provide float during the period that GAs have not been reimbursed by ED for default claims. Lenders could submit claims directly to ED. The competitive bidding process would result in lower unit costs than ED's proposal, which proposes a per-loan fee based on current GA expenditures, and continuation of the cost allowance based on a percentage of new loan volume. Nonperforming contractors could be terminated with substantially less political controversy than a State agency or non-profit organization having a designation by the Secretary.

(3) Reduce return to lenders. Savings: -\$2.8 billion. This package would be the same as option 1, except that it does not propose requiring lenders to offer income-contingent repayment. It does include the additional proposal to reduce the return to the lender during the in-school period, which was not part of the FY 1997 Budget package.

(4) Reduce Federal administrative costs. Savings: -\$0.5 billion over FY 1998-2002, and -\$1 billion in 2002. [Same as options 1 and 2]

RECOMMENDATION: Option 2. Either proposal -- contracting for the essential functions performed by GAs, or ED's semi-restructuring -- will be opposed in Congress by supporters of the guaranteed loan program. A proposal to replace GAs designated by ED with performance-based contracts awarded by competitive bids is a straightforward statement of how best to achieve effective cost control and program integrity. A more detailed review is needed of potential savings that could be realized.

Terms and conditions of the direct and guaranteed program for borrowers should be as consistent as possible to avoid inequities, but it is not possible, or even desirable, to achieve a perfectly "level playing field" between programs with such difference incentive structures.

It would be desirable to eliminate borrower up-front fees, and have the borrower's interest payments in the direct loan program cover Federal costs, but we have not identified appropriate offsets for reducing costs to borrowers (whether from fees or interest), and there are unresolved issues regarding how accurately current Federal scoring represents Federal costs in both programs, but particularly in the direct loan program.

It is not realistic for the Federal government to attempt to require banks and secondary markets to offer income-contingent repayment and cancellation of payments after 25 years, and to estimate substantial savings. Banks have resisted all efforts to liberalize repayment options to borrowers across-the-board. The direct student loan program can offer continue income-contingent repayment through loan "consolidation" into the direct loan program even to borrowers who have a guaranteed loan.

A remaining Federal cost issue in both programs is default losses, which will require reconsideration of student and institutional eligibility requirements and standards as well as Federal management. As part of the larger reauthorization package, consideration will be given to institutional performance standards as a supplement to or replacement for the default rate "kick-out" provision in identifying schools whose poor performance results in excessive Federal costs and program abuse, by making many needy students who attempt postsecondary education worse off by having assumed debt and not having bettered their economic circumstances.

Barry:

Here is the current draft of the loan paper. The floating baseline (the question of whether the savings proposed in the FY97 budget are used or available) makes the comparison of the options more confusing than I would like. Your thoughts, please.

--Bob

Issue Paper --
Department of Education
(In millions of dollars)

ISSUE: Student loans (Federal Family Education Loans and Federal Direct Student Loans)

	<u>FY 1998</u>	<u>FY 1999</u>	<u>FY 2000</u>	<u>FY 2001</u>	<u>FY 2002</u>	<u>Total</u>
Baseline OL.....	2,850	3,003	3,219	3,417	3,627	16,117
[Federal Family Education Loans]	(2,102)	(1,808)	(1,799)	(1,900)	(1,998)	(9,608)
[Federal Direct Loans]	(95)	(518)	(700)	(719)	(736)	(2,767)
[Student loan administration]	(653)	(677)	(720)	(799)	(893)	(3,742)

change (looks like negatives)

Option 1:

OL increase/decrease from current service baseline	-2,526	752	784	808	832	-1,337
---	--------	-----	-----	-----	-----	--------

The agency request is to reduce borrower fees, lender yield, and Federal administrative costs, and restructure guaranty agencies. **Caveat:** Several of ED's proposed savings were part of the Administration's 1997 Budget, totalling \$3 billion. When those savings are assumed to be already part of Administration policy, ED's proposal costs \$1.7 billion.

Option 2:

OL increase/decrease from FY97 policy baseline.	-1,785	238	256	255	247	-789
--	--------	-----	-----	-----	-----	------

Reduce borrower fees by a lesser amount. Reduce lender yield and Federal administrative costs as in option 1. Replace guaranty agencies with contractors in the guaranteed program. Assume that savings proposed by ED in option 1 that were included in the 1997 Budget have already been taken for deficit reduction.

DESCRIPTION OF ISSUE: The President has supported allowing institutions of higher education to choose which of the two student loan programs best meets their needs and the needs of their students. Even though the direct loan program has been universally praised by participating institutions, ED has not achieved the goals specified in the statute for loan volume; currently 38% of total loan volume is in the direct program, though the goal for academic year 1996/97 is 50%. This may at least partly reflect institutional uncertainty regarding the future of the program because of repeated Congressional assaults during 1996 and 1997, but the improvements made by the lenders and guaranty agencies in service to institutions and borrowers are at least partly responsible. Competition from direct lending has improved the guaranteed program, and many institutions participating in the guaranteed program support the continuation of both programs in order to continue the trend of improvements in the bank-based program. In competing for market share, however, banks and guaranty agencies have greater flexibility in adjusting their fees and interest rates than the Federal government, and ED has been at a disadvantage when reductions were implemented by the players in the guaranteed program. ED wants to reduce borrower fees to make loans cheaper for students and equalize terms in the two programs.

Further, the guaranteed loan program presents ongoing management problems, particularly regarding the performance of the agencies in integrity of financial data, cost control, and default prevention. Aggregate agency revenues (totalling an estimated \$600 million in FY 1997) are derived from borrower insurance premiums, Federal administrative cost allowances (based on .85% of new loan volume), investment income from Federal reserves, and 27% of collections on defaulted loans. ED estimates that this income significantly exceeds costs; consequently reserves increase each year, and there are no effective controls on how the agencies spend these funds. As long as guaranty agencies exist, with their financial incentives and ED's lack of leverage over them, it is unlikely that the underlying problems will be solved.

ANALYSIS: The two options (ED's proposal and the PAD recommendation) both would equalize fees in the in the guaranteed and direct loan programs, reduce lender yields and take back guaranty agency reserves beyond the levels proposed in current budget policy, and make a number of other changes in the programs. The options differ primarily in the way they answer these two questions:

1. Should fees be further reduced, particularly for low and moderate income students? Or is deficit reduction the priority for this program? ED recommends eliminating the origination fee altogether for students in the Stafford loan program (which requires a demonstration of need). This uses \$1.7 billion of the savings assumed in the FY97 budget. The PAD recommendation preserves the \$3 billion in deficit reduction in the policy baseline.

2. How should the "guaranty agencies" be restructured? ED would retain the designated-agency structure for administering current loan guarantee system, but would change it in several ways: the entities would need to be periodically re-certified; they would hold only a "working capital" fund, rather than reserves; they would be focused more on default prevention; and the current variety of arbitrary (and sometimes perverse) politically-set fees would be replaced with just two arbitrary and politically-set fees. To ensure loan access and to provide a check on agency costs, ED would lift the current limit on the FISL loan program which allows the Secretary to guarantee loans directly rather than through intermediaries. The PAD recommends, instead, that the guarantee system be

administered through contracts rather than by designating agencies. ED objects to the contractor approach, asserting that it is politically safer and that it is important that the secretary retain his current discretion in the selection of agencies.

SCORING ISSUES: Two peculiarities with the current interpretation of the Federal Credit Reform Act (FCRA) should be pointed out, one which understates, and one which may overstate, the costs of direct lending.

(1) Administrative funds: Intense debates with Congress have taken place in the budget/appropriations process regarding comparative Federal program costs and subsidy rates for the two student loan programs because of the requirement in the FCRA to budget Federal administrative costs on an annual cash basis. In contrast, lenders' administrative costs in the FFELP are paid by the borrower and Federal interest payments over the life of the loan.

The Budget Resolutions in FY 1996 and 1997 required CBO to use a baseline including Federal administrative costs for the direct student loan program, but not the FFELP; the budget and authorizing committees believed the scoring under the FCRA to give direct lending an unfair advantage. Under current law and with current interest rates, the direct loan subsidy rate is about 9 points higher than that of the FFELP. If Federal administrative costs were included in the subsidy rate for both student loan programs, and the reductions to the FFELP proposed in this paper were enacted, the subsidy rate for the two programs would be approximately the same, with direct lending being possibly a little higher, depending on interest rate projections. This scoring issue will likely be part of the reauthorization debate, and a CBO/OMB report with recommendations may be desirable.

(2) Discount rate: In estimating net present values, the FCRA calls for the discount rate to be "the average interest rate on marketable Treasury securities of *similar maturity* to the direct loan or loan guarantee." For the student loan programs, OMB and CBO currently use the average of a 10-year and 20-year Treasury bond [**Is that right?**]. But some have argued that a variable rate loan reaches "maturity" each time it varies (every year, in the case of student loans). Indeed, Sallie Mae finances its lending primarily through short-term securities, both because borrower interest changes annually (up to a cap), and because the Federal government protects it from interest fluctuation every quarter. The assumption that the Federal cost-of-borrowing is the longer-term rate considerably reduces the NPV of income from future payments on direct student loans, and reduces the NPV of the cost of defaults in the guarantee program.

DESCRIPTION OF OPTIONS:

Option 1: ED proposes the following changes: (1) Reducing borrower fees. Cost: \$3.3 billion. In the Direct Loan program, the borrower pays an origination fee of 4% of the loan amount to offset Federal costs. In the guaranteed loan program (the Federal Family Education Loan Program, or FFELP), the borrower pays an origination fee of 3%, and in addition, the guaranty agency (GA) has the option of charging the borrower an "insurance premium" of not more than 1%. ED proposes --

- to eliminate the 1% insurance premium that a guaranty agency may require all FFELP borrowers to pay [no cost],

- to reduce the origination fee for borrowers in the Direct Loan program from 4% to 3% [cost: \$.9 billion], and
- to eliminate the remaining 3% borrower origination fee in both programs only for all “subsidized” borrowers, that is, needy students, whose in-school interest is subsidized [cost: \$2.5 billion].

(2) Restructuring guaranty agencies. Savings: -\$1.5 billion. ED proposes to change the guarantor function, and achieve savings by requiring the return of \$2 billion in reserve funds. ED proposes to eliminate the current statutory annual cap of \$2 billion on the volume of loans that the Federal government can guarantee loans directly. The 1992 Amendments to the Higher Education Act clarified that the Federal government is the guarantor in the event of guaranty agency insolvency. ED is not prepared to replace GA’s with contractors for the operation of the FFELP, but proposes that the Secretary continue to designate them, requiring their periodic recertification. Under ED’s proposal GA’s would retain enough reserves to pay lender claims until they are reimbursed by ED (\$300 million), and to pay 6 months of operating costs (\$100 million). ED proposes to compensate GA’s through (a) an annual administrative cost allowance based on a percentage of new loans guaranteed, and (b) a per-loan “operations fee” based on total portfolio, budgeting these expenses on a present value basis as part of the subsidy rate, rather than budgeting them on a cash basis. Lenders would pay GAs a default prevention fee.

(3) Reducing return to lenders. Savings: -\$2.8 billion. ED proposes to reduce lenders’ return while the student is in school to the rate at which ED borrows from Treasury, reduce lender insurance from 98% to 90%, extend the .3% Sallie Mae fee on loans it holds to other secondary markets, increase the lender origination fee from .5% to .8%, and create a new loan holder fee. All these were part of the 1997 Budget except for the reduction in the return to the lender during the in-school period..

(4) Level the playing field between the two programs. No cost/savings. ED’s current proposals would standardize the terms and conditions of consolidated loans in both the direct and guaranteed programs, and require lenders that offer discounts to offer them to all borrowers (no creaming). [ED still has under consideration requiring lenders to offer the same repayment options as in direct lending, including income-contingent repayment.]

(5) Reduce Federal administrative costs. Savings: -\$1.5 billion. In the Student Loan Reform Act of 1993, sec. 458 provides mandatory authority for administrative costs for FY 1994- 1998. ED has projected a baseline for FY 1999-2002 consistent with the estimates in the statute for the earlier years, and experience has indicated that savings can be achieved allowing reductions in that baseline.

Option 2: (1) Equalise borrower fees, but do not lower them even further. Cost: \$.9 billion. Eliminate the 1% insurance premium that guaranty agency may require all FFELP borrowers to pay [no cost], and reduce the origination fee for all borrowers in the Direct Loan program from 4% to 3% [cost: \$.9 billion].

(2) Terminate GA’s and award or expand Federal contracts to accomplish the record-keeping, claims payment, default

prevention and default collection functions. Savings: -\$1.5 billion. ED estimates that it will cost approximately \$300 million per year to finance these GA functions. Because of ED's inadequate data on realistic costs for these functions, it is not possible to estimate specific additional savings, but we believe they could be substantial. The number of contractors needed would be much fewer than the 38 GA's now operating. There would be no need for working capital to provide float during the period that GAs have not been reimbursed by ED for default claims. Lenders could submit claims directly to ED. The competitive bidding process could result in lower unit costs than ED setting a per-loan fee based on current GA expenditures, and continuing to pay a cost allowance based on a percentage of new loan volume. Nonperforming contractors could be terminated with substantially less political controversy than a State agency or non-profit organization having a designation by the Secretary.

(3) Reduce return to lenders. Savings: -\$2.8 billion. This package would be the same as option 1. All of these were part of the 1997 Budget except the reduction in the return to the lender during the in-school period.

(4) Level the playing field between the two programs. No cost/savings. Same as option 1.

(5) Reduce Federal administrative costs. Savings: \$-.5 billion. Same as option 1.

(6) Reduce savings in 1-4 above by the \$3 billion in reductions assumed in the 1997 Budget, leaving \$800 million in savings.

RECOMMENDATION: Option 2. Contracting for the essential functions performed by GAs is a cleaner, more justifiable approach than ED's semi-restructuring proposal. With regard to student fees, it would be good to reduce them further, but the savings necessary to do so have already been "spent" in the policy baseline.

**Agency Mandatory Summary
Department of Education
(outlays in millions of dollars)**

	<u>FY 1997</u>	<u>FY 1998</u>	<u>FY 1999</u>	<u>FY 2000</u>	<u>FY 2001</u>	<u>FY 2002</u>	<u>Total FYs 1997-2002</u>
Baseline.....							
Direct student loan subsidy		95	518	700	719	736	2,767
Guaranteed student loan subsidy		2,102	1,808	1,799	1,900	1,998	9,608
Student loan admin. funds		653	677	720	799	893	3,742
Total		2,850	3,003	3,219	3,417	3,627	16,117
Policy reductions from FY 1997 Budget:		(1,046)	-519	-486	-495	-495	(3,031)
Additional FY 1998 Policy changes proposed by ...							
Agency		(1,480)	752	784	808	832	1,695
Additional Policy changes in FY 1998 Recommended Level		(1,785)	238	256	255	247	-789
		<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total FY 1998 Recommended Level.....		1,065	3,241	3,475	3,672	3,874	15,328

MEMORANDUM

TO : Bob Shireman, Chief
Education Branch, OMB

FROM : Thomas P. Skelly, Director
Budget Systems Division

SUBJECT : Student Loan Policy Options for FY 1998 Budget

Attached are the Department's policy options for the FFEL and Direct Student Loans programs for the FY 1998 President's Budget, along with corresponding cost estimates. Please call me if you have any questions. Thanks.

BROAD STUDENT LOAN OPTIONS

The following are the Department of Education's recommendations for changes to the Federal Family Education Loan Program (FFEL) and the William D. Ford Federal Direct Loan Program (Direct Loans). The objectives of these changes are to:

- o Provide the best benefits and service possible to students and families.
- o Promote direct lending.
- o Complement the President's HOPE scholarship proposal by providing additional benefits to low-income students.
- o Increase efficiency and effectiveness of the student loan system.
- o Reduce the cost of the student loan programs to taxpayers, but not at expense of students.
- o Reduce default costs by reducing defaults and increasing collections.

The Department recommends lowering student fees, which costs roughly \$3.3 billion dollars over five years. That cost will be offset by other proposals that save \$4.6 billion. In combination these proposals are estimated to save \$1.3 billion. See the attached table for more information on cost estimates. Specifically, the Department recommends the following changes:

- o Lower fees for students:
 - eliminate the one percent guaranty agency fee and lower Direct Loan fees by one percent.
 - eliminate all origination fees (additional 3 percent) for subsidized loan borrowers.
- o Lower FFEL subsidies.
- o Require lenders to offer discounts to all borrowers.
- o Provide similar terms and conditions on all consolidation loans (excluding repayment provisions).
- o Restructure guarantee agencies and emphasize their role in preventing defaults.
- o Increase the Department's authorities for debt collection.
- o Establish a \$15,000 loan limit for PLUS borrowers.
- o Increase loan limits for HEAL borrowers.
- o Require the Department of Defense to pay for military deferments.

NOTE: The Department has included two options here regarding extension of repayment plans in direct loans to FFEL (including income contingent repayment) but has not made a recommendation. One option would save an additional \$800 million; the other would not have any cost effects. The Department expects to make such a recommendation shortly.

To minimize the ability of FFEL lenders to dump high risk loans into direct loans, a provision needs to be added that puts some of the risk on private lenders. These options, and others, need to be considered carefully. Options include having the originator of the loan bear the risk even if

the loan is sold or converted into direct lending or a transaction fee imposed each time a FFEL loan is transferred into direct loans.

LOWER FEES FOR STUDENTS

The Department would like to reduce costs for students much as possible, particularly for low- and middle-income students. The options recommended here assume that current interest rates (except for in-school rates) and grace periods will continue and that the Department will lower students' costs through reduction in fees at the front end of borrowing rather than reductions while borrowers are in repayment. Front end reductions in fees provide students more funds at the time that they are paying for their educations. The two options recommended below would increase outlays by \$3.3 billion over five years.

Eliminate 1% guarantee agency fee and lower direct loan fees by 1%.

Pros

- o Provides direct benefit to students; puts more funds into the hands of students when they are paying their college bills.
- o Ensures that waiver of the GA fee does not result in lower costs for FFEL borrowers than in direct loans.
- o Reduces build-up of unnecessary GA reserves if GAs are not restructured as discussed later.

Cons

- o Costs federal government about \$860 million over five years.
- o Could place some GAs in financial jeopardy if GAs are not restructured as discussed later.

Cost estimate

- o Costs federal government about \$860 million over five years.

Eliminate origination fees for subsidized loan borrowers

This option assumes that the 1% GA fee is eliminated and direct loan fees are lowered by 1%. Origination fees are then lowered an additional 3% for students with subsidized loans.

Pros

- o Provides a direct and very significant benefit to the most needy students. Puts more funds into the hands of students when they are paying their college bills.
- o Administration of the subsidized loan program would be easier for schools, lenders, and the Department.
- o Counters arguments that the Administration is not doing anything for low-income students.

Cons

- o Increases federal costs significantly, by \$2.5 billion over five years.
- o Does not provide the same benefit to borrowers of unsubsidized loans and PLUS borrowers. To provide the same benefits to unsubsidized loans and PLUS borrowers would cost \$1.9 billion over five years.

Cost estimate

- o Lowering the fees for subsidized loans would cost \$2.5 billion in outlays over five years.

LOWER FFEL LENDER SUBSIDIES

The published financial statements of some large lenders and the fact that FFEL lenders are providing discounts to students through reduced fees and interest rates, are indications that excess profits still remain in the FFEL system. This section recommends ways to reduce lender subsidies and federal costs while benefiting students, increasing incentives to prevent defaults, and putting direct loans and FFEL on more equal footing.

Pros

- o Price competition and available financial results indicate that subsidy level is excessive, at least for large lenders.
- o Reduces federal costs.
- o The in-school interest option benefits some students.
- o The reinsurance options would increase lender and GA efforts to prevent defaults.
- o Puts direct loans and FFEL on more equal footing to compete (level playing field).

Cons

- o Excessive reductions could result in loan access problems, although options to address lender access, including increases in direct loan volume and mandatory-service, equal-treatment requirements, would alleviate these concerns.

Other issues

- o Limits lender ability to discount loan costs for students (interest rates and origination fees) since lender profits will be reduced.
- o Large lenders could still discount loan costs if excess profits remain in the system, giving a comparative advantage to large lenders.
- o Depending upon the particular reductions chosen, the balances between large and small lenders and/or long-term holders and secondary-market pipelines could be changed.

Specific Ways to Reduce Lender Subsidies:

- o Set in-school interest rate at the ED borrowing rate.
 - Reduces federal costs.
 - Reduces payments to lenders during time when lender has few servicing costs on subsidized loans and therefore the highest profit levels.
 - Immediately benefits students with unsubsidized loans.
 - Reduces risk to students with subsidized loans from future reductions in federal in-school subsidy.
 - Estimated to save \$850 million over 5 years.
- o Other pieces.
 - Reduce lender reinsurance rate from 98% to 95% (1997 budget--saves \$330 million).
 - Further reduce reinsurance rate to 90 % while removing GA co-insurance fee and due diligence requirements for lenders (net savings \$170 million).
 - Extend Sallie Mae fee to entire secondary market (1997 budget--saves \$420 million).
 - Create semi-annual loan holder fee (1997 budget--saves \$250 million).
 - Increase lender origination fee from .5% to .8% (1997 budget--saves \$230 million).
 - Together these five pieces are estimated to save roughly \$1.4 billion over 5 years.
- o The unresolved issue is whether these cuts are too deep and the extent to which access problems would arise. Options to address lender access could be included including mandatory-service, equal-treatment requirements and/or increases in direct loans volume. Lowering the interest rate while students are in school should be the first change made in lender subsidies since this would reduce lender profits while lowering costs for some students.

Cost estimate

- o All six options discussed above are estimated to save about \$2.2 billion over five years. With all of these changes, direct and FFEL subsidy estimates are roughly equal if administrative costs are included in direct loan subsidy estimates.

REQUIRE LENDERS TO OFFER DISCOUNTS TO ALL BORROWERS

Nondiscrimination provisions and requirements for lenders to serve everyone would help to promote equal costs for all borrowers while alleviating lender discounting, particularly if coupled with significant reductions in lender subsidies. Nondiscrimination provisions would also help to prevent forcing poorer quality schools into DLs, and make FFEL a borrower entitlement (like DLs). Without a mandate, however, the extent and size of lender discounts would depend on the extent to which other options reduced lender profit margins. Mandate is not as necessary if lender profits are significantly reduced (as discussed previously).

Pros

- o Ensures that all students at a given lender face the same costs. Coupled with reductions in lender yields, nondiscrimination requirements will reduce different prices.
- o Are not limiting what private lenders can do to provide better benefits to students.

Cons

- o Students will face different costs depending on their lender. Only way to totally guarantee that FFEL cannot compete with direct loans on student price is through mandates.
- o Could cause lenders to leave FFEL and offer alternative loan programs to only the most credit - worthy students.

Cost estimate

- o No cost implications to the federal government if the distribution of borrowing in FFEL and direct loans is unchanged. Savings do occur, however, if volume increases in the direct loan program and decreases in FFEL.

OPTIONS REGARDING REPAYMENT PLANS

Option 1: Require FFEL lenders to offer the array of repayment options currently available in the direct loan program, including the income contingent, graduated, extended, and alternative repayment plans.

Pros:

- o Provides equal benefits to borrowers in the Direct and FFEL programs.
- o Provides increased flexibility to FFEL borrowers if they do not want to consolidate into direct loans.
- o Would benefit DL if lenders fail to meet their obligations.
- o Saves the federal government \$800 million over five years.

Cons:

- o May encourage lenders to promote consolidation of higher risk loans into Direct Loans, particularly if the government does not assume the write-off risk. (This could be countered by retaining default risk in the transferor program.)
- o Would be difficult to administer.
- o Income information from the IRS may not be easily available to lenders to administer the income contingent repayment plan.
- o Could cause lenders to leave FFEL.

Cost estimate

- o Estimated to save \$800 million in outlays over five years due to lower default payments.

Option 2: Prohibit FFEL lenders from offering repayment plans longer than 10 years.

Pros:

- o Helps ensure that the Direct Loan program remains competitive -- retains a big advantage that Direct Loans has over FFEL.
- o Avoids potential problems that lenders would have servicing the loans.
- o Helps ensure that Direct Loans continue to cost the government less money than FFEL loans.

Cons:

- o Repayment plans will differ significantly between the two programs.
- o Borrowers' repayment options will vary based solely on where they went to school; however, borrowers can get the other repayment plans by consolidating into direct loans. (Need to make it easier for borrowers to consolidate into direct loans so that they can get all repayment options.)
- o Lenders will argue that this option is an attack on the FFEL program.

Cost estimate

- o No estimated cost effect.

PROVIDE SIMILAR TERMS AND CONDITIONS ON ALL CONSOLIDATION LOANS (except for repayment plans, which are discussed above).

At present, FFEL benefits in consolidation are more costly for borrowers than in direct loans. This option would extend terms and conditions of direct consolidation loans to FFEL consolidation loans including interest rates, keeping the subsidized portion of loans when in consolidation, allowing consolidation while in school, and allowing consolidation of consolidation loans. Retaining default risk in the program where the loan was originated would reduce/eliminate FFEL lenders shifting high risk loans into direct loan program.

Pros

- o Provides borrowers in FFEL and direct loans more similar benefits.
- o Levels playing field between FFEL and direct loans.

Cons

- o Removes some incentives for borrowers to consolidate into direct loans. Even so, however, some borrowers will still want to consolidate to obtain the income contingent repayment plan or the other repayment plans offered in Direct Loans.

Cost estimate

- o No cost effects estimated.

RESTRUCTURE GUARANTEE AGENCIES

Restructure the funding of guarantee agencies and their relationships with ED to treat them more like contractors while retaining the Secretary's current discretion in their selection. This change

would more accurately reflect the actual roles, responsibilities and functioning of guarantee agencies in the FFEL program. Specific changes include, for example, limited time agreements with GAs, elimination of reserve funds, changes in GA reimbursements, and emphasis of role in preventing defaults.

Pros

- o Total package of changes to restructure GAs would save roughly \$2 billion in federal costs over five years, after elimination of the 1% GA fee.
- o GA restructuring would help to ensure a more rational and efficient FFEL system.
- o Will be supported by lenders and some GAs.

Cons

- o Will be viewed by the FFEL community as another attack on the guaranteed student loan system.

Cost estimate

- o Full package of changes would save an estimated \$2 billion over five years, after elimination of the 1% GA fee.

INCREASE THE DEPARTMENT'S AUTHORITIES FOR DEBT COLLECTION

Improving the Department's access to data sources, allowing direct matching to state employees records and salary offset, and extending the period for reporting negative credit information are several ways to increase collections on defaulted student loans.

Pros

- o Increases collections of student loans.
- o Improves the public image of the loan programs and improves the Department's credibility with Congress.

Cons

- o May be opposed by the IRS and other government agencies.
- o May place increased burdens on states.
- o May be opposed by consumer protection organizations because of privacy concerns.

Cost estimate

- o No scorable savings; CBO will follow the same procedures in their estimates.

ESTABLISH A \$15,000 ANNUAL LOAN LIMIT FOR PLUS BORROWERS

Pros

- o Would protect against overborrowing by parents.
- o Would alleviate some concerns that uncapped federal aid allows institutions to raise their prices excessively.

Cons

- o Could restrict access.
- o Few PLUS borrowers (2%) now borrow more than \$15,000.
- o Would encourage creation of alternative loan plans.

Cost implications

- o No cost implications due to the small number of PLUS borrowers now borrowing more than \$15,000.

INCREASE LOAN LIMITS FOR HEAL BORROWERS

Pros

- o Provides needed funds for medical and dental students who would have been eligible for HEAL program loans if the program had been continued.

Cons

- o Increases administrative burden for the Department and lenders to determine which borrowers would have been eligible for HEAL and to determine applicable loan limits for these borrowers.
- o Other professional students--such as lawyers and MBA students--are likely to request similar increases.

Costs

- o Costs already assumed in baseline estimates.

REQUIRE THE DEFENSE DEPARTMENT TO PAY FOR MILITARY DEFERMENTS

Pros:

- o The military deferment is designed to assist military recruitment and provide a benefit to military personnel. Accordingly, the Defense Department, not the Department of Education, should pay for this cost.
- o Small savings to the Department of Education.

Cons:

- o May add administrative complexity.

Cost estimate

- o Not measurable.

REDUCE SECTION 458 ADMINISTRATIVE FUNDING LEVELS

Reduce student aid administrative funds by \$480 million over five years from the current service baseline. Reductions in these mandatory costs that are outside the subsidy levels were included in the 1997 budget. ED feels that the remaining administrative costs (\$3.6 billion over five years) are sufficient to administer the student aid programs.

FY 1998 Student Loan Policy Options Preliminary Cost Estimates

	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002	FY 1998-02
1) Lower Fees for Students						
a) Eliminate 1% guaranty agency fee and lower Direct Loan origination fee by 1%						
Eliminate guaranty agency fee						
BA	0	0	0	0	0	0
O	0	0	0	0	0	0
Lower Direct Loan fee						
BA	176	203	215	227	240	1,061
O	95	171	187	198	209	860
Total						
BA	176	203	215	227	240	1,061
O	95	171	187	198	209	860
b) Eliminate origination fees for subsidized borrowers						
Eliminate 3% fee for FFEL						
BA	256	230	226	248	266	1,226
O	140	217	206	217	235	1,015
Eliminate 3% fee for Direct Loans						
BA	176	203	215	227	240	1,061
O	95	171	187	198	209	860
Total						
BA	556	573	586	623	656	2,994
O	305	514	528	553	585	2,485
Total Costs of Lower Fees for Borrowers						
BA	732	776	801	850	896	4,055
O	400	685	715	751	794	3,345

	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002	FY 1998-02
2) Lower FFEL Lender Subsidies						
a) Set- in-school interest rate at ED borrowing rate						
BA	-256	-176	-186	-194	-205	-1,017
O	-140	-188	-165	-173	-182	-848
b) Reduce lender reinsurance from 98% to 95%						
BA	-80	-72	-77	-80	-85	-394
O	-49	-67	-69	-72	-77	-334
c) Further reduce lender reinsurance rate to 90%						
BA	-138	-124	-132	-141	-149	-684
O	-85	-116	-118	-126	-133	-578
d) Increase agency default reinsurance payment to 100%						
BA	98	87	93	99	104	481
O	60	82	83	89	94	408
e) Extend Sallie Mae fee to entire secondary market						
BA	-298	-36	-39	-41	-43	-457
O	-281	-33	-34	-36	-38	-422
f) Create semi-annual loan holder fee						
BA	-59	-56	-59	-62	-65	-301
O	-32	-51	-52	-55	-57	-247
g) Increase lender origination fee from .5% to .8%						
BA	-58	-44	-54	-56	-56	-268
O	-37	-44	-46	-51	-52	-230
Total Savings from Reduced Lender Subsidies						
BA	-791	-421	-454	-475	-499	-2,640
O	-564	-417	-401	-424	-445	-2,251
3) Require lenders to offer discounts to all borrowers						
BA	0	0	0	0	0	0
O	0	0	0	0	0	0

	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002	FY 1998-02
4) Standardize terms and conditions on Consolidation Loans						
a) Allow in-school consolidation of FFEL loans						
BA	0	0	0	0	0	0
O	0	0	0	0	0	0
b) Allow FFEL consolidators to retain Stafford interest benefits						
BA	0	0	0	0	0	0
O	0	0	0	0	0	0
<i>Note: There could be a cost of up to \$407 million (outlays) with extensive in-school consolidation</i>						
c) Standardize interest rate calculations on Direct Loan model						
BA	0	0	0	0	0	0
O	0	0	0	0	0	0
d) Allow consolidation of Consolidation Loans in FFEL						
BA	0	0	0	0	0	0
O	0	0	0	0	0	0
Total Savings from Standardizing Consolidation Loan Terms						
BA	0	0	0	0	0	0
O	0	0	0	0	0	0
5) Restructure Guaranty Agencies/Increase Default Prevention Efforts						
a) Eliminate guaranty agency insurance premium						
BA	0	0	0	0	0	0
O	0	0	0	0	0	0
b) Move administrative cost allowance to FFEL subsidy						
BA	115	109	116	125	130	595
O	115	109	116	125	130	595
c) Remove administrative cost allowances from Section 458						
BA	-115	-109	-116	-125	-130	-595
O	-115	-109	-116	-125	-130	-595
d) Eliminate supplemental pre-claims assistance payments						
BA	-70	-9	-10	-10	-10	-109
O	-66	-9	-9	-9	-9	-102

	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002	FY 1998-02
e) Reduce default retention from 27% to 0%.						
BA	-469	-56	-60	-63	-66	-714
O	-442	-52	-53	-56	-59	-662
f) New operations fee paid to agencies by ED						
BA	173	173	173	173	173	863
O	173	173	173	173	173	863
g) New default prevention fee paid to agencies by lenders						
BA	0	0	0	0	0	0
O	0	0	0	0	0	0
h) Return of agency reserves						
BA	-1,878	-46	-60	-46	-42	-2,072
O	-1,878	-46	-60	-46	-42	-2,072
i) Less 1/2 of excess cash for non-loan activities						
BA	17	23	30	23	21	114
O	17	23	30	23	21	114
j) Net return of agency reserves						
BA	-1,862	-23	-30	-23	-21	-1,959
O	-1,862	-23	-30	-23	-21	-1,959
k) Allow claim filing prior to payment						
BA	0	0	0	0	0	0
O	0	0	0	0	0	0
l) Authority to advance additional working capital						
BA	0	0	0	0	0	0
O	0	0	0	0	0	0
m) Require periodic recertification of guaranty agencies						
BA	0	0	0	0	0	0
O	0	0	0	0	0	0
n) Remove cap on FISL						
BA	0	0	0	0	0	0
O	0	0	0	0	0	0
o) Expand LLR provisons to Unsubsidized Loans						
BA	0	0	0	0	0	0
O	0	0	0	0	0	0

	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002	FY 1998-02
p) Provide advances directly to lenders for LLR loans						
BA	0	0	0	0	0	0
O	0	0	0	0	0	0
q) Allow Direct Loans to provide LLR loans						
BA	0	0	0	0	0	0
O	0	0	0	0	0	0
r) Modify conflict of interest provisions for guaranty agencies						
BA	0	0	0	0	0	0
O	0	0	0	0	0	0
s) Eliminate trustee banks						
BA	0	0	0	0	0	0
O	0	0	0	0	0	0
t) Remove limitations on fees for violations						
BA	0	0	0	0	0	0
O	0	0	0	0	0	0
u) Allow schools to originate loans to graduate and professional students						
BA	0	0	0	0	0	0
O	0	0	0	0	0	0
v) Remove nonfunctioning provisions						
BA	0	0	0	0	0	0
O	0	0	0	0	0	0
w) Require Sallie Mae fee on securitized loans						
BA	0	-6	-18	-29	-39	-92
O	0	-6	-18	-29	-39	-92
Total Savings From Restructuring Guaranty Agencies						
BA	-2,228	79	55	48	36	-2,011
O	-2,197	83	63	56	44	-1,952
6) Increase the Department's authorities for debt collection						
BA	0	0	0	0	0	0
O	0	0	0	0	0	0
7) Establish a \$15,000 loan limit for PLUS borrowers						
BA	0	0	0	0	0	0
O	0	0	0	0	0	0

	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002	FY 1998-02
<u>8) Increase loan limits for HEAL Borrowers</u>						
BA	0	0	0	0	0	0
O	0	0	0	0	0	0
<u>9) Reduce Section 458 funding levels</u>						
BA	-218	-58	-59	-60	-61	-456
O	-155	-122	-80	-67	-61	-485
<u>Total Savings</u>						
BA	-2,505	376	343	363	372	-1,052
O	-2,516	229	297	316	332	-1,343
<u>Savings from current service baseline</u>						
BA	-2,505	376	343	363	372	-1,052
O	-2,526	232	298	322	338	-1,337
<u>Savings from policy currently assumed in budget (policy baseline)</u>						
BA	-1,270	854	847	884	909	2,223
O	-1,480	752	784	808	832	1,695
<u>Possible Changes to Repayment Plans</u>						
a) Extend Current Direct Loan repayment plans to FFEL (Gov't pays after 25 years)						
BA	-201	-194	-203	-215	-229	-1,042
O	-87	-173	-174	-183	-195	-812
b) Maintain current FFEL repayment plans						
BA	0	0	0	0	0	0
O	0	0	0	0	0	0

14-Nov-96
Budget Service



UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF POSTSECONDARY EDUCATION

Office of the Deputy Assistant Secretary
Policy, Planning and Innovation

7th and D Streets, SW
Room 4060, ROB-3
Washington, DC 20202-5143
Phone: (202) 205-2987 Fax: (202) 401-5749

Fax Cover Sheet

Number of pages following cover sheet: 8

TO: Bob SHIPENIAN

FAX: 395-4875

FROM:

Maureen A. McLaughlin ✓

Lynn Mahaffie _____

Tia Cosey _____

Francine Picoult _____

Sandy Wood _____

Janet Sharps _____

MESSAGE:

BROAD STUDENT LOAN OPTIONS

*- what is the problem(s)
that need to be addressed?
it has been the successful.*

**NOT FOR DISTRIBUTION
DRAFT**

**NOTE STILL WAITING FOR
SOME COST ESTIMATES; ALL
ESTIMATES ROUGH**

11/08/96

3:00 p.m.

Objectives:

- o Provide best benefits and service possible to students and families.
- o Provide equal benefits to borrowers in Direct and FFEL programs.
- o Promote direct lending.
- o Encourage two strong student loan programs.
- o Increase efficiency and effectiveness of student loan system.
- o Reduce cost of student loan program to taxpayers, but not at expense of students.
- o Reduce default cost by reducing defaults and increasing collections.

ELIMINATE 1% GUARANTEE AGENCY FEE AND LOWER DIRECT LOAN FEES BY 1%Pros

- o Provides direct benefit to students.
- o Ensures same level of fees for all students in direct loans and FFEL.
- o Reduces build-up of unnecessary GA reserves.

Cons

- o Costs federal government about \$850 million over five years and reduces the potential savings from restructuring the GAs (see p.5 below) by \$__ million.

Cost estimate

- o Costs federal government about \$850 million over five years.

LOWER FFEL LENDER SUBSIDIESPros

- all loans or just some??
costs (??, orig.??)*
- o Price competition and available financial results indicate that subsidy level is excessive, at least for large lenders.
 - o Reduces federal costs.
 - o Puts direct loans and FFEL on more equal footing to compete (level playing field).

Cons

- o Excessive reductions could result in loan access problems, although options to address lender access including increases in direct loan volume and mandatory-service, equal-treatment requirements would alleviate these concerns.

Other issues

- o Limits lender ability to discount loan costs for students (interest rates and origination fees) since lender profits will be reduced.
- o Large lenders could still discount loan costs if excess profits remain in the system, giving a comparative advantage to large lenders.
- o Depending upon the particular reductions chosen, the balances between large and small lenders and/or long-term holders and secondary-market pipelines could be changed.

Specific Ways to Reduce Lender Subsidies:

- o Set in-school interest rate at the rate the Department is charged for borrowing. *- T-bill??* *- what rate is that?*
 - Reduces federal costs.
 - Reduces payments to lenders during time when lender has few servicing costs on subsidized loans and therefore the highest profit levels.
 - Immediately benefits students with unsubsidized loans.
 - Reduces risk to students with subsidized loans from future cost in federal subsidy.
 - Estimated to save \$850 million net over 5 years (\$___ savings in FFEL minus \$___ reduced income in DLs).
- o Other pieces: From 1997 budget
 - Extend Sallie Mae fee to entire secondary market.
 - Create semi-annual loan holder fee.
 - Increase lender origination fee from .5% to .8%.
 - Reduce lender reinsurance rate from 98 to 95%.
 - Together these four pieces are estimated to save roughly \$1.2 billion over 5 years. (What are the assumptions in this estimate on changes with FFEL and direct loan volume?)
- o The unresolved issue is whether these cuts are too deep and the extent to which access problems would arise. Options to address lender access could be included including mandatory-service, equal-treatment requirements and/or increases in direct loans volume.

Interplay of the 98 reduction??

Cost estimate

- o Doing all five options discussed above are estimated to save about \$2 billion over five years and to reduce the FFEL subsidy to about 10% (subsidized and unsubsidized combined). With all of these changes, direct and FFEL subsidy estimates are roughly equal if administrative costs are included in direct loan subsidy estimates.

Yell

MANDATE THAT FFEL LENDERS CANNOT OFFER DISCOUNTS (REDUCED INTEREST RATES, FEES, OR REBATES)

Maybe for GAs - 1% fee

Pros

- o Equal benefits for all students in FFEL and direct loans.
- o Riskier borrowers do not face higher prices than other borrowers. — *emphatic has to pay*
- o Levels playing field between direct loans and FFEL.

Cons

- o Some borrowers in FFEL will face higher costs than would otherwise be the case if some lenders were discounting.
- o Will be viewed as anti-borrower since FFEL community will indicate that this is something they are doing at "no cost to the federal government".
- o Without a mandate, the extent and size of lender discounts would depend on the extent to which other options reduced lender profit margins. Mandate is not as necessary if lender profits are significantly reduced (as discussed previously).

Nondiscrimination provisions and requirements for lenders to serve everyone could help to alleviate lender discounting, particularly if coupled with significant reductions in lender subsidies. Nondiscrimination provisions would also help to prevent forcing poorer quality schools into DLs, promotes access, and makes FFEL a borrower entitlement (like DLs). The only way to guarantee that FFEL cannot compete with direct loans on student price is through mandates.

Cost estimate

No cost implications to the federal government if the distribution of borrowing in FFEL and direct loans is unchanged. Savings do occur, however, if volume increases in the direct loan program and decreases in FFEL.

REDUCE STUDENT ORIGINATION FEES BEYOND 1 PERCENT REDUCTION IN FIRST OPTION

This option assumes that current interest rates (except for in-school rates on unsubsidized loans) and grace periods will continue and that the Department will look to lower students' costs through reduction in fees.

Pros

- o Provides a direct and very significant benefit to students.
- o Administration of the loan programs would become easier for schools, lenders, and the Department if we eliminate totally the fees (3 percentage points) rather than simply reducing them.

Cons

- o Increases federal costs significantly.

Cost estimate

- o Increases federal costs significantly. Each 1 percentage point reduction increases federal costs by \$ __ billion over 5 years. Eliminating the fees entirely would cost \$ __ billion over five years.

REQUIRE FFEL LENDERS TO OFFER THE ARRAY OF REPAYMENT OPTIONS CURRENTLY AVAILABLE IN THE DIRECT LOAN PROGRAM, INCLUDING THE INCOME CONTINGENT, GRADUATED, EXTENDED, AND ALTERNATIVE REPAYMENT PLANS

Pros

- o Provides equal benefits to borrowers in the Direct and FFEL programs.
- o Provides increased flexibility to FFEL borrowers.
- o Saves the federal government \$800 million over five years (due to lower default costs) assuming that the government pays for loan forgiveness at the end of 25 years. If lenders pay the cost of forgiveness, federal savings increase to roughly \$1 billion over five years.
- o Reduces FFEL default rate by enabling borrowers to repay over a longer term and according to income and debt.

Cons

- o May encourage lenders to promote consolidation of higher risk loans into direct loans. This could be countered by retaining default risk in the program where the loan originated.

of course

- o Would be difficult for lenders and the Department to administer.
- o Income information from the IRS may not be available to lenders to administer the income contingent repayment plan. [The IRS may agree to give this information to lenders if borrower consent is a condition of ICR in FFEL.]

*Not really
harder to access*

Cost estimate

Saves the federal government \$800 million over five years assuming that the government pays for loan forgiveness at the end of 25 years; saves about \$1 billion if lenders pay the costs of forgiveness.

*Bad
for direct
lenders*

PROVIDE SAME TERMS AND CONDITIONS ON ALL CONSOLIDATION LOANS

At present, FFEL benefits in consolidation are more costly for borrowers than in direct loans. This option would extend terms and conditions of direct consolidation loans to FFEL consolidation loans including interest rates keeping the subsidized portion of loans when in consolidation, allowing consolidation while in school, and allowing consolidation of consolidation loans. Retaining default risk in the program where the loan was originated will reduce/eliminate FFEL lenders shifting high risk loans into direct loan program.

Cost?

*Is this a
problem?*

Pro

- Allow consol. of DL into FFEL?

- o Provides borrowers in FFEL and direct loans the same benefits.
- o Provides benefits to FFEL borrowers in terms of an array of repayment options.

Cons

- o Removes incentive for borrowers to consolidate into direct loans.

Cost estimate

[Cost implications??]

RESTRUCTURE GUARANTEE AGENCIES

- o Restructure the funding of guarantee agencies and their relationships with ED to treat them more like contractors while retaining the Secretary's current discretion in their selection. This change would more accurately reflect the actual roles, responsibilities and functioning of guarantee agencies in the FFELP program. Specific changes include, for example, limited time agreements with GAs, elimination of reserve funds, and changes in GA reimbursements.

Pros

- o Total package of changes to restructure GAs would save \$2.5 billion in federal costs over five years.
- o GA restructuring would help to ensure a more rational and efficient FFEL system.
- o Will be supported by lenders and some GAs.

! mostly
on term of reserves

Cons

- o Will be viewed by the FFEL community as another attack on the guaranteed student loan system.

— All of it? What about banks?

- Could a new entrant offer the services??

Cost estimate

Full package of changes would save an estimated \$2.5 billion over five years.

— How??

INCREASE LENDER AND GA EFFORTS TO PREVENT DEFAULTS BY ESTABLISHING A LENDER-FINANCED FEE TO GA'S FOR SUCCESSFUL PRECLAIMS ASSISTANCE AND FURTHER REDUCING LENDER INSURANCE

Pros

- o Would reduce default by increasing lender and GA incentives to avert defaults.
- o No cost to the federal government. (Savings from reduced lender insurance should be used to finance elimination of GA coinsurance, which would no longer be necessary and inconsistent with new GA structure.)

Cons

???

Cost estimate

No cost.

INCREASE THE DEPARTMENT'S AUTHORITIES FOR DEBT COLLECTION, INCLUDING IMPROVING THE DEPARTMENT'S ACCESS TO DATA SOURCES, ALLOWING DIRECT MATCHING TO STATE EMPLOYEES RECORDS AND SALARY OFFSET, AND EXTENDING THE PERIOD FOR REPORTING NEGATIVE CREDIT

INFORMATION.Pros

- o Increases collections of student loans.
- o Improves the public image of the loan programs and improves the Department's credibility with Congress.
- o May result in scorable budget savings for the federal government.

Cons

- o May be opposed by the IRS and other government agencies.
- o May place increased burdens on states.
- o May be opposed by consumer protection organizations.

Cost estimate

Waiting for cost estimate; will include range for possible savings.

INCLUDE ADMINISTRATIVE COSTS FOR DIRECT LOANS IN THE MANDATORY SIDE OF THE BUDGETObjective:

To prevent opponents from starving direct loans by reductions in appropriations for administrative costs.

Options:

- o Calculate administrative costs for both FFEL and direct loans in subsidy calculations that are automatically provided through mandatory funds.
- o Reserve a certain percent of repaid direct loans for administrative costs.

Cost implications

???

ADDITIONAL ISSUE

OMB is considering a credit reform package that would change the way subsidies are calculated in the loan programs, including changing the way we determine comparable maturity instruments in credit programs and inclusion of administrative costs.

summary

What?

- Do nothing in recap:

- no rule Δ , same # in the baseline.

MELBO MODBS

- Consider loan delivery via DL model and:

(a) "sell" portfolios to lenders (Eld in trust by govt for lenders??)
(Gov't gets benefit of capital, passes along in all spreads)
(or they had before and it's just moved there)
WITH GUR. (contract w/ Gov't types in trade)

- what about ICR?

(b) state but the gear is 'sold' as

- better fin. measures

8

- need a standard portfolio mechanism

(c) put decision in students' hands (ad. need a default option) - cd be chosen by student when business.
- w/ or w/o gear.

Reminder: it's remarkable we're here, with D.C. schools:

- Nervously denying there ~~at all~~ existed any such proposal
- 5% pilot - 'You'll never get more than that...'

Why we won:

① We're right

② We kept fighting

~~Department for~~

- Forster said a failure because didn't hit 90%
→ 1/3 market share in just 2 years!! (NCL/Sprink vs. AP+T)

• SAD brought reforms for all

- £2 billion in reduced fees for students
- Lower of costs
- Improved systems for schools
- Savings for taxpayers...

- There's no going back... but where to go from here??

• Competitive model:

- Equalize benefits

- 'Inform' AP+T admin (G.A.'s, neutrals), get savings \$\$\$

• Beyond competition?

- When: - Reconciliation?

- Reach

} Also: who gets benefits of savings.

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET

Route Slip

To: Barry White	Take necessary action	
Education Branch	Approval or signature	
	Comment	
	Prepare reply	
	Discuss with me	
	For your information	x
	See remarks below	

From: Aromie Noe *AN*

Date: September 17,
1996

Remarks:

For your information, attached is a draft of ED's plan for HEA reauthorization.

As you will see in the schedule, ED plans to send its proposal to Congress by April 30, 1996. (Some ED people seem skeptical about the feasibility of meeting this deadline.)

In addition, when ED officials (Smith, Longanecker, Hicks, McLaughlin, Davidson, etc.) met last week, Smith told the attendees that the Department would now consider not only minor but also major changes to the current HEA. (According to Davidson, at that meeting, Smith acknowledged that he had changed his view on the scope of changes ED should pursue in the HEA reauthorization.)

I told Davidson that we want ED to brief us in detail about its plan, schedule, and strategy soon. I am now told that McLaughlin or her staff will contact us shortly.

September 10, 1996

Draft~~HRT~~ Reauthorization Schedule

Create issue teams and appoint chairs for each team	September 12
Invite staff from relevant offices to participate in teams	September 12
Steering committee establishes goals and principles for reauthorization	September 20
Each team prepares a detailed outline of topics and list of general options	October 4
<u>Publish notice in Federal Register seeking comment</u>	October 4
Steering committee meets to discuss outlines prepared by issue teams	October 10
Each team prepares issues, options and analysis	November 27
<u>Meet with the higher education community (on going)</u>	Fall
<u>Meet with the Hill staff (on going)</u>	Fall
Policy decisions from the Deputy Secretary and the Assistant Secretary	December 13
Meeting with Secretary Riley on general directions	Dec/Jan
Meeting with OMB on general directions	Dec/Jan
Each group drafts concrete proposals and <u>OGC begins drafting legislative language</u>	February 21
Final decisions made by Deputy Secretary and Assistant Secretary	February 28
Regional hearings for public comment	March 3-7
Meeting with Secretary for final decisions	Mid March
Send proposal to OMB for clearance	March 29
Send proposal to the Hill	April 30

*Draft**August 29, 1996*

Reauthorization Issue Teams

ED is creating the following nine issue teams to look at individual topics for reauthorization of the Higher Education Act. The teams will consist of representatives from all relevant offices within the Department and will be co-chaired by two people from OPE -- one policy person and one program person. The co-chairs will be responsible for developing the initial work plan and for including others with necessary expertise from OPE.

- **Loans -- Lynn Mahaffie, Linda Hall**
- **Grants and campus-based programs -- Steve Carter, Harold McCullough**
- **Tax and savings proposals -- Dan Madzelan, Denise Boulanger**
- **Overarching issues -- David Bergeron, Carney McCullough**
- **Delivery system and need analysis -- Joe Mike, Michaelyn Milidantri**
- **Gatekeeping and oversight -- Adam Ochlis, John Cantaloupo**
- **Linkages -- Phil Schulz, Fran Bergeron**
- **Educational and institutional improvement -- David Johnson, Carl Person**
- **Graduate and international education -- Karen Wenk, Uri Monson**

The following is a list of the statutory provisions and issues that each group should consider. Groups should consider whether to recommend eliminating programs that are not funded.

*Draft**August 29, 1996***Loans****HEA Sections:**

Title IV, Part B -- Federal Family Education Loan Program
Part D -- Direct Loan Program

Potential Issues:

- Why not
implementing?*
- The future of the Direct Loan and FFEL programs, including issues relating to choice and level playing field;
 - Operation and management of the FFEL program;
 - Repayment plans;
 - Terms of subsidized, unsubsidized, PLUS, and consolidation loans, including deferment and forbearance, loan limits, origination fees, etc.;
 - State share of default cost;
 - Default reduction program;
 - Debt collection;
 - Cohort default rates;
 - Burden reduction (e.g., multiple disbursement of loans, 30-day delayed disbursement, overaward tolerance, etc.);
 - Student Loan Marketing Association;
 - Performance-based system for lenders;
 - Establishment of a line of credit system; and
 - Changes to the HEA if the HEAL program is eliminated.

[NOTE: Given the broad subject matter covered by this group, we anticipate that the co-chairs will create subgroups, perhaps on the following issues: level playing field/terms of loans, FFEL operation and management, and default management/debt collection. Staff with relevant backgrounds will be asked to head and/or work on the subgroups.]

*Draft**August 29, 1996***Grants/Campus-Based Programs****HEA Sections and Legislative Proposal:**

Title IV, Part A, Subpart 1 -- Pell Grant Program

Subpart 2, Chapter 3 -- Presidential Access Scholarships

Subpart 3 -- Federal Supplemental Educational Opportunity Grants

Subpart 4 -- Grants to States for State Student Incentives

Subpart 6 -- Robert C. Byrd Honors Scholarship Program

Part C -- Work-study

Part E -- Federal Perkins Loans

The President's proposal for honors scholarships for the top 5% of each high school class

Potential Issues:

- Changes to the Pell Grant program (e.g., award formulas, front-loading grants, need calculations, better targeting of lower income students, exclusion of students in short-term programs, making Pell an entitlement, etc.);
- Allowing transfer of funds among campus-based programs;
- Consolidation of programs;
- Changes to work-study (e.g., expand the program, encourage ties between work-study jobs and career choices, eliminating community service requirement, etc.);
- Formulas;
- Award limits; and
- Merit-based aid.

Draft

August 29, 1996

Tax and Savings Proposals**Statutory Provision and Legislative Proposals:**

The President's HOPE Scholarship Proposal
The President's education tax deduction proposal
Title IV, Part A, Subpart 2, Chapter 6 -- National Student Savings Demonstration Program
The President's IRA proposal

Potential Issues:

- Any changes that must be made to the HEA to coordinate with legislation on the HOPE scholarship and/or the education tax deduction; [NOTE: The HOPE scholarship, education tax deduction, and any other tax legislation are not part of the HEA; however, these proposals should be considered as part of the entire system for helping students pay for postsecondary education. We will work with the Department of the Treasury on all issues relating to HOPE, the education tax deduction, and any other tax proposals for higher education.]
- How to set up an information reporting system for the HOPE scholarship and education tax deduction programs;
- How to encourage families to save for postsecondary education (e.g., early counseling for parents on saving for college, IRAs, relationship with need analysis, state tuition repayment plans, savings bonds, etc.); and
- How to encourage the private sector to invest money in higher education.

*Draft**August 22, 1996*

Overarching Issues

HEA Sections:

All relevant sections.

Potential Issues:

- How to respond to new educational delivery modes (telecommunications, distance learning, technology, full-year instruction, school-to-work);
- How to handle the large influx of students expected as the babyboom echo reaches college age;
- The balance of loan and grant money;
- Financial aid packaging (*e.g.*, guaranteed amount of aid, packaging for multiple years);
- Mobility of students and institutions across state lines;
- Federal/state partnerships to coordinate state pricing and aid policies with federal aid policies;
- Smartcard;
- College costs;
- Creating a persistence initiative for students (*e.g.*, converting loans into grants upon program completion);
- Creating a persistence initiative for institutions (*e.g.*, performance-based funding for institutions); and
- Different approaches for different kinds of students.

*Draft**August 29, 1996*

Delivery System and Need Analysis

HEA Sections:

Title IV, Part A, Subpart 2, Chapter 7 -- Preeligibility
Chapter 8 -- Technical Assistance for Teachers and
Counselors
Part F -- Need Analysis
Part G -- General Provisions (except section 487A -- Quality Assurance)
Title XII -- General Provisions

Potential Issues:

- Shared responsibility among students, families, and state and federal governments to pay for college;
- Changes to need analysis (e.g., define "independent student", reduce penalties for working students, eliminate provisions that discourage savings, discourage income manipulation, look at indirect costs, and consider nontraditional students);
- The delivery system, including EASI;
- Interaction between financial aid and welfare programs;
- Burden reduction (e.g., refund policy);
- Verifications and disclosures not directly related to the administration of programs (e.g., Selective Service verification, immigration verification, and athletic disclosures);
- Ability to benefit test;
- Campus Security Act;
- Student and institutional eligibility; and
- The use of professional judgment by financial aid administrators.

*Draft**August 29, 1996***Gatekeeping/Oversight****HEA Sections:****Title IV, Part H -- Program integrity triad****Part G, Section 487A -- Quality Assurance Program (including experimental sites)****Potential Issues:**

- How to protect students and federal dollars from waste, fraud, and abuse.
- How to provide more flexibility to the department to administer programs in a performance-based way;
- How to reduce burden on institutions, students and families;
- How to increase institutional discretion and flexibility while ensuring accountability;
- How to improve accountability;
- Issues relating to the structural changes occurring in IPOS;
- The roles of accrediting agencies and the states;
- Frequency of audits;
- Program reviews; and
- Technology/distance learning.

*Draft**August 29, 1996***Educational and Institutional Improvement****HEA Sections:**

Title I, Part C -- Access and Equity to Education for all Americans Through
Telecommunications
Title III -- Institutional Aid
Title VII -- Construction, reconstruction, renovation of academic facilities
Title X, Part A -- Fund for Improvement of Postsecondary Education (except international
programs)
Part D -- Eisenhower Leadership Program
Howard University Endowment Act

Potential Issues:

- Strengthening institutions;
- Appropriate federal role in facilities;
- Support for providing computers for students;
- Support for development of high quality instructional software and multi-media programming;
- Support for research on cost effectiveness of technology-based instruction;
- Mini FIPSEs; and
- Support for Howard University.

[NOTE: Library and teacher programs are outside OPE. We need a separate group for these programs.]

*Draft**August 29, 1996***Linkages****HEA Sections:**

Title I -- Partnerships for Educational Excellence (except Part C)

Title IV, Part A, Subpart 2, Chapter 1 -- Trio

Chapter 2 -- Early Intervention

Chapter 4 -- Community Partnership

Chapter 5 -- Public Info

Subpart 5 -- Special programs for students whose families are engaged
in migrant and seasonal farm work.

Subpart 8 -- Special childcare services for disadvantaged college
students

Title VIII -- Cooperative education

Title X, Part B -- Minority science and engineering improvement programs

Part C -- Women and minorities science and engineering outreach demonstration
program

Title XI -- Community Service

Potential Issues:

- Changes to TRIO programs;
- Combining the coop ed, work-study, and school-to-work programs;
- Improving information provided to consumers;
- Expanding early intervention efforts; and
- Developing better ties with elementary and secondary institutions:

*Draft**August 29, 1996***Graduate and International Education****HEA Sections:**

Title VI -- International programs

Title IX -- Graduate programs

Title X, Part A -- FIPSE (international programs only)

Potential Issues:

- Combining programs;
- Whether the graduate programs should continue to have a need-based component;
and
- Whether the graduate programs should address national need.

David L.'s "themes"

Reauthorization

I. Opportunity but with responsibility

- Families
- Students
- Institutions

II. High standards/higher achievement

- Federal programs
- Institutions - quality of ed., stud. outcomes
- Students

III. Changes appropriate to the times

- Demographics
- Limited resources
- Change in educational delivery system (technology, face-to-classroom)
- Reducing burden
- Assuring accountability
- school-to-work - (corp. ed., CWS, experiential ed.)
transition

"Improving management" - when does it go?

FY 1998 Budget -- Loan Policy Options

Policies Affecting Guaranty Agencies

Proposals Included in the FY 1997 Budget

- 1) Eliminate Supplemental Pre-Claims Assistance -- These payments, which are intended to encourage agencies to help lenders prevent defaults, have proven to be ineffective.

FY 1998-02 Outlay Savings: -\$102 million

- 2) Reduce Default Collection Retention from 27 Percent to 18.5 Percent -- This change would bring the retention level--which is intended to cover agency collection costs--in line with actual costs at the Department and the most efficient agencies.

FY 1998-02 Outlay Savings: -\$393 million

- 3) Reduce Reinsurance Rate from 98/88/78 to 96/86/76 -- *This proposal would be dropped if Proposal 7 below is adopted for FY 1998.*

FY 1998-02 Outlay Savings: -\$224 million

- 4) Recall Portion of Unneeded Agency Reserve Funds -- *This proposal would be dropped if Proposal 6 below is adopted for FY 1998.*

FY 1998-02 Outlay Savings: -\$600 million

- 5) Pay Agencies 18.5 Percent of Balance on Consolidations of Defaulted Loans -- This was originally proposed to put into statute current regulations concerning collection costs for newly consolidated defaulted loans. *The Department is reconsidering these regulations; this provision therefore should be dropped for the FY 1998 Budget.*

FY 1998-02 Outlay Savings: \$0

New Proposals

- 6) Reduce Agency Reserve Level to Amount Needed for 6 Months of Operations -- This proposal would replace the current reserve system--under which agencies control over \$2 billion in Federal funds--with a "working capital" model under which agencies would retain only enough cash to finance general operating expenses for the next 6 months plus \$300 million to finance default claim payments for the period between payment of the claims and reimbursement by the Department. All funds over this amount would be returned to the Treasury as excess.

FY 1998-02 Outlay Savings: -\$1,676 million

3 Nov 96

Policies Affecting Lenders, Loan Holders, and the Secondary Market

Proposals Included in the FY 1997 Budget

- 1) Extend the Current Sallie Mae Offset Fee to All Secondary Market Participants -- This proposal would apply the current fee, equal to 0.3 percent of outstanding principal held, equitably across all participants in the FFEL secondary market.

FY 1998-02 Outlay Savings: -\$422 million

- 2) Increase Origination Fee Paid By Lenders from .5 Percent to .8 Percent -- *This proposal would be dropped if proposal 5 below is adopted for FY 1998.*

FY 1998-02 Outlay Savings: -\$231 million

- 3) Reduce Reinsurance Rate from 98 Percent to 95 Percent -- *This proposal would be dropped if proposal 5 below is adopted for FY 1998.*

FY 1998-02 Outlay Savings: -\$334 million

- 4) Create a Semi-Annual Fee of .035 Percent on All Loan Holdings -- *This proposal would be dropped if proposal 5 below is adopted for FY 1998.*

FY 1998-02 Outlay Savings: -\$247 million

New Proposals

- 5) Set In-School Interest Rate at Government Borrowing Rate -- This would extend the current structure under which lenders receive a lower in-school interest rate --T-Bill plus 2.5 percent, rather than 3.1 percent--as a reflection of their lower servicing costs prior to loans entering repayment. Under current law, this distinction will disappear when the interest rate basis shifts to the 10-Year rate plus 1 Percent in FY 1998.

FY 1998-02 Outlay Savings: -\$848 million

- 6) Require Lenders to Offer Same Repayment Plans Available Under Direct Loans -- This would give borrowers in both FFEL and Direct Loans access to the same repayment plans. This proposal assumes that the government would assume the costs of forgiveness of original loan principal under income-contingent repayment, and that, as in Direct Loans, borrowers would be able to switch between repayment plans at any time. Lenders would be required to offer these repayment plans to all eligible borrowers.

FY 1998-02 Outlay Savings: -\$812 million

Policies Affecting Guaranty Agencies -- Continued

- 7) Increase Agency Default Reinsurance Payment to 100 Percent -- This would effectively eliminate the guaranty agencies' role as loan reinsurers, a function that is in fact carried out by the Federal government. (A modification to this approach would be to have the Department make default claim payments directly through electronic funds transfer.) This proposal should be viewed in conjunction with Proposal 6 above, for which it provides additional justification.

FY 1998-02 Outlay Cost: \$407 million*

* This reflects the cost from current services. Adopting this proposal would also eliminate \$224 million in savings associated with Proposal 3 above.

- 8) Require Lenders to Pay Guaranty Agencies for Bringing Delinquent Loans Current -- This would give both lenders and agencies an additional incentive to prevent defaults.

FY 1998-02 Outlay Savings: \$0

- 9) Move Administrative Cost Allowances to the FFEL Subsidy -- This would return to the approach used prior to the Student Reform Act of 1992, which gave the Secretary authority to adjust these payments as necessary to ensure a smooth transition from FFEL to Direct Loans. Since the decision has been made to operate both programs, and Congress has consistently overridden Secretarial discretion in this area through appropriations language, it is appropriate that these payments be returned to the subsidy. (This change would increase the FFEL subsidy rate.)

FY 1998-02 Outlay Cost: \$596 million

- 10) Require Periodic Recertification of Guaranty Agencies -- This would subject agencies to accountability mechanisms similar to those already in place for other program participants such as institutions and accrediting agencies.

FY 1998-02 Outlay Savings: \$0

GA-Related FY 1998-02 Outlay Savings (Including Interactive Effects): -\$1,169 million
(Savings Assuming FY 1997 President's Budget: -\$150 million)

Policies Affecting Lenders, Loan Holders, and the Secondary Market -- Continued

- 7) Eliminate Special Allowance Payments for All New Loans -- These payments are no longer necessary, since current financial instruments offer lenders sufficient resources to ensure the return on their investment in student loans.

FY 1998-02 Outlay Savings: \$0

- 8) Remove Limitation on Authority to Make FISL Program Loans -- This would allow the government to use the FISL program to address borrower access problems.

FY 1998-02 Outlay Savings: \$0

Lender-Related FY 1998-02 Outlay Savings (Including Interactive Effects): -\$2,082 million (Savings Assuming FY 1997 President's Budget: -\$848 million)

Policies Affecting Borrowers

Proposals Included in the FY 1997 Budget

- 1) Limit PLUS Borrowing to \$15,000 Annually -- *The Department recommends eliminating this proposal, which unnecessarily limits borrower flexibility, for FY 1998.*

FY 1998-02 Outlay Savings: \$0

New Proposals

- 2) Eliminate 1 Percent Borrower Insurance Fee -- In conjunction with Proposal 2 below, this would reduce costs for borrowers and equalize financial incentives for both borrowers and schools in choosing between FFEL and Direct Loans. In addition, lenders would not be allowed to discriminate in providing further reductions in origination fees to prospective borrowers.

FY 1998-02 Outlay Savings: \$0

- 3) Reduce Direct Loan Origination Fee by 1 Percent -- In conjunction with Proposal 2 below, this would reduce costs for borrowers and equalize financial incentives for both borrowers and schools in choosing between FFEL and Direct Loans.

FY 1998-02 Outlay Cost: \$860 million

Policies Affecting Borrowers -- Continued

- 4) Standardize Consolidation Loan Interest Rates on Direct Loan Formula -- This would eliminate the current situation where borrowers pay different interest rates depending on whether they consolidate through FFEL or Direct Loans

FY 1998-02 Outlay Savings: \$0

- 5) Allow FFEL Consolidators to Retain Stafford Interest Subsidy Benefits -- This would equalize borrower benefits across the two programs.

FY 1998-02 Outlay Savings: \$0*

← why is it 0

* This estimate assumes that all consolidations occur after loans have entered repayment. If in-school consolidations are allowed in FFEL, this option would cost \$490 million.

- 6) Deny Eligibility to Consolidate to Certain Defaulters -- This would prevent hard-core defaulters--those who are subject to court judgements, wage garnishment, or Federal salary offset--from voiding these coercive payment arrangements through consolidation.

FY 1998-02 Outlay Savings: \$0

- 7) Allow Use of FAFSA as FFEL Application -- This allows students to use a single form to apply for all Federal student aid programs and addresses a longstanding complaint from the FFEL community.

FY 1998-02 Outlay Savings: \$0

- 8) Require SSA and INS Matches for PLUS Applicants -- This would subject PLUS applicants to the same eligibility checks required of student applicants.

Not allowed now?

FY 1998-02 Outlay Savings: -\$5 million

- 9) Allow FFEL Consolidators to Reconsolidate to Add Previous Loans After 180-Day Window -- This would offer FFEL borrowers the same benefits now available under Direct Loans, under which borrowers who fail to include a loan in their initial Consolidation Loan can add that loan under a subsequent Consolidation.

FY 1998-02 Outlay Savings: \$0

Borrower-Related FY 1998-02 Outlay Costs: \$855 million (Costs Assuming FY 1997 President's Budget: \$855 million)

Policies Affecting Schools

New Proposals

- 1) Eliminate Improper Servicing as Grounds for Appeal of Cohort Default Sanctions -- Only one school has successfully appealed under this criteria, which is extremely costly and labor-intensive to adjudicate.

FY 1998-02 Outlay Savings: \$0

Policies Affecting the Department of Education

Proposals Included in the FY 1997 Budget

- 1) Reduce Administrative Spending Under Section 458 -- The new levels would reflect actual projected needs, rather than the levels authorized in the Student Loan Reform Act.

FY 1998-02 Outlay Savings: -\$479 million

New Proposals

- 2) Move Administrative Cost Allowances to the FFEL Subsidy -- This would return to the approach used prior to the Student Reform Act of 1992, which gave the Secretary authority to adjust these payments as necessary to ensure a smooth transition from FFEL to Direct Loans. Since the decision has been made to operate both programs, and Congress has consistently overridden Secretarial discretion in this area through appropriations language, it is appropriate that these payments be returned to the subsidy. (This change would increase the FFEL subsidy rate.)

FY 1998-02 Outlay Cost: -\$596 million

Department-Related FY 1998-02 Outlay Savings: -\$1,075 million (Savings Assuming FY 1997 President's Budget: -\$596 million)

Total FY 1998-02 Outlay Savings¹: -\$3,471 million (Savings Assuming FY 1997 President's Budget: -\$439 million)

¹The FY 1997 Budget included the elimination of the \$10 per borrower fee to Direct Loan institutions. The elimination of this fee is already assumed in the baseline.

**US Department of Education
Cost Estimate**

The following are loan savings options for FY 98-02. The estimates are based on FY 98 OMB submission volumes and FY 97 MSR interest rates.

FY 97 & FY 98 Budget Options		FY 98	FY 99	FY 00	FY 01	FY 02	FY 98-02	
GA	Eliminate Supplemental Preclaims Assistance (includes \$59 in prior cohort savings)	BA	(70)	(9)	(10)	(10)	(10)	(109)
		O	(66)	(9)	(9)	(9)	(9)	(102)
	Recall portion of unneeded agency reserve funds	BA	(120)	(120)	(120)	(120)	(120)	(600)
		O	(120)	(120)	(120)	(120)	(120)	(600)
	Reduce default retention from 27% to 18.5% (includes \$244 million in prior cohort savings)	BA	(279)	(34)	(36)	(37)	(39)	(425)
		O	(263)	(31)	(31)	(33)	(35)	(393)
	Reduce GA reinsurance rate from 98/88/78 to 96/86/76; no GA complement	BA	(53)	(49)	(51)	(54)	(57)	(264)
		O	(33)	(45)	(46)	(49)	(52)	(224)
	Increase agency default reinsurance payment to 100%	BA	98	87	93	99	104	481
		O	60	82	83	89	94	407
	Pay agencies 18.5% of balance on consolidations of defaulted loans (proposal no longer requested)	BA	0	0	0	0	0	0
		O	0	0	0	0	0	0
	Reduce agency reserve level to amount needed for 6 months of operations	BA	(1,664)	(12)	0	0	0	(1,676)
		O	(1,664)	(12)	0	0	0	(1,676)
	Require lenders to pay guaranty agencies for bringing delinquent loans current	BA	0	0	0	0	0	0
		O	0	0	0	0	0	0
	Move administrative cost allowances to the FFEL subsidy	BA	124	111	113	120	127	596
		O	124	111	113	120	127	596
	Require periodic recertification of guaranty agencies	BA	0	0	0	0	0	0
		O	0	0	0	0	0	0
	GA interactive changes (includes \$600 million in negated FY 97 GA reserve savings and \$264 million in negated FY 97 savings due to the increase of GA reinsurance from 96/86/76 to 100%)	BA	173	169	171	174	177	864
		O	153	165	166	169	172	824
GA/BA			(1,792)	143	160	172	182	(1,134)
GA/O			(1,809)	141	156	166	177	(1,169)

Lender	Create a semi-annual fee of .035% on all loan holdings	BA	(59)	(56)	(59)	(62)	(65)	(301)
		O	(32)	(51)	(52)	(55)	(57)	(247)
	Extend the current Sallie Mae offset fee to all secondary market participants (includes \$259 million prior cohort savings)	BA	(298)	(36)	(39)	(41)	(43)	(458)
		O	(281)	(33)	(34)	(36)	(38)	(422)
	Increase origination fee paid by lenders from .5% to .8%	BA	(58)	(44)	(54)	(56)	(56)	(268)
		O	(37)	(44)	(46)	(51)	(52)	(231)

Reduce lender reinsurance rate from 98% to 95%	BA	(80)	(72)	(77)	(80)	(85)	(394)
	O	(49)	(67)	(69)	(72)	(77)	(334)
Set in-school interest rate at the government borrowing rate	BA	(256)	(176)	(186)	(194)	(205)	(1,017)
	O	(140)	(188)	(165)	(173)	(182)	(848)
Require lenders to offer same repayment plans available under Direct Loans	BA	(201)	(194)	(203)	(215)	(229)	(1,043)
	O	(87)	(173)	(174)	(183)	(195)	(812)
Remove limitation on authority to make FISL program loans	BA	0	0	0	0	0	0
	O	0	0	0	0	0	0
Eliminate special allowance payments for all new loans	BA	0	0	0	0	0	0
	O	0	0	0	0	0	0
Lender interactive changes (includes \$962 million in FY 97 negated lender savings)	BA	196	172	190	199	206	962
	O	119	162	167	178	186	812

Lender BA	(755)	(406)	(427)	(451)	(477)	(2,517)
Lender O	(508)	(395)	(372)	(392)	(415)	(2,082)

Student	Reduce Direct Loan origination fee by 1%	BA	176	203	215	227	240	1,059
		O	95	171	187	198	209	860
	Limit PLUS borrowing to \$15,000 annually (proposal no longer requested)	BA	0	0	0	0	0	0
		O	0	0	0	0	0	0
	Eliminate the 1% borrower insurance fee	BA	0	0	0	0	0	0
		O	0	0	0	0	0	0
	Require SSA and INS matches for PLUS applicants	BA	(1)	(1)	(1)	(1)	(1)	(5)
		O	(1)	(1)	(1)	(1)	(1)	(5)
	Allow use of FAFSA as FFEL application	BA	0	0	0	0	0	0
		O	0	0	0	0	0	0
	Allow FFEL consolidators to retain Stafford interest subsidies benefits (\$0 savings assumes that all consolidations occur after entering repayment; option costs \$490 million if consolidations occur in the in-	BA	0	0	0	0	0	0
		O	0	0	0	0	0	0
	Standardize Consolidation loan interest rates on Direct Loan formula	BA	0	0	0	0	0	0
		O	0	0	0	0	0	0
	Deny eligibility to consolidate certain defaulters	BA	0	0	0	0	0	0
		O	0	0	0	0	0	0
	Allow FFEL consolidators to reconsolidate to add previous loans after the 180 day window	BA	0	0	0	0	0	0
		O	0	0	0	0	0	0

Student BA		175	202	214	226	239	1,054
Student O		94	170	186	197	208	855

School	Eliminate improper servicing as grounds for appeal of cohort default sanctions	BA	0	0	0	0	0
		O	0	0	0	0	0

School BA		0	0	0	0	0	0
School O		0	0	0	0	0	0

Admin	Reduce administrative spending under Section 458	BA	(218)	(58)	(59)	(60)	(61)	(456)
		O	(165)	(119)	(79)	(61)	(55)	(479)

	Move administrative cost allowance to the FFEL subsidy	BA	(124)	(111)	(113)	(120)	(127)	(596)
		O	(124)	(111)	(113)	(120)	(127)	(596)

Admin BA		(342)	(169)	(172)	(180)	(188)	(1,052)
Admin O		(289)	(230)	(192)	(181)	(182)	(1,075)

Total BA		(2,714)	(231)	(226)	(233)	(244)	(3,648)
Total O		(2,511)	(314)	(223)	(211)	(212)	(3,471)

**US Department of Education
Cost Estimate**

The following are loan savings options for FY 98-02. The estimates are based on FY 98 OMB submission volumes and FY 97 MSR interest rates.

		FY 97 Budget Options	FY 98	FY 99	FY 00	FY 01	FY 02	FY 98-02
GA	Eliminate Supplemental Preclaims Assistance (includes \$59 in prior cohort savings)	BA	(70)	(9)	(10)	(10)	(10)	(109)
		O	(66)	(9)	(9)	(9)	(9)	(102)
	Recall portion of unneeded agency reserve funds	BA	(120)	(120)	(120)	(120)	(120)	(600)
		O	(120)	(120)	(120)	(120)	(120)	(600)
	Reduce default retention from 27% to 18.5% (includes \$244 million in prior cohort savings)	BA	(279)	(34)	(36)	(37)	(39)	(425)
		O	(263)	(31)	(31)	(33)	(35)	(393)
	Reduce GA reinsurance rate from 98/88/78 to 96/86/76; no GA complement	BA	(53)	(49)	(51)	(54)	(57)	(264)
		O	(33)	(45)	(46)	(49)	(52)	(224)
	Pay agencies 18.5% of balance on consolidations of defaulted loans (proposal no longer requested)	BA	0	0	0	0	0	0
		O	0	0	0	0	0	0
GA BA			(522)	(212)	(217)	(222)	(227)	(1,399)
GA O			(481)	(205)	(206)	(211)	(215)	(1,319)
Lender	Create a semi-annual fee of .035% on all loan holdings	BA	(59)	(56)	(59)	(62)	(65)	(301)
		O	(32)	(51)	(52)	(55)	(57)	(247)
	Extend the current Sallie Mae offset fee to all secondary market participants (includes \$259 million prior cohort savings)	BA	(298)	(36)	(39)	(41)	(43)	(458)
		O	(281)	(33)	(34)	(36)	(38)	(422)
	Increase origination fee paid by lenders from .5% to .8%	BA	(58)	(44)	(54)	(56)	(56)	(268)
		O	(37)	(44)	(46)	(51)	(52)	(231)
	Reduce lender reinsurance rate from 98% to 95%	BA	(80)	(72)	(77)	(80)	(85)	(394)
		O	(49)	(67)	(69)	(72)	(77)	(334)
Lender BA			(494)	(208)	(228)	(240)	(250)	(1,420)
Lender O			(399)	(196)	(201)	(214)	(224)	(1,234)
Student	Limit PLUS borrowing to \$15,000 annually (proposal no longer requested)	BA	0	0	0	0	0	0
		O	0	0	0	0	0	0
Student BA			0	0	0	0	0	0
Student O			0	0	0	0	0	0
Admin	Reduce administrative spending under Section 458	BA	(218)	(58)	(59)	(60)	(61)	(456)
		O	(165)	(119)	(79)	(61)	(55)	(479)
Admin BA			(218)	(58)	(59)	(60)	(61)	(456)
Admin O			(165)	(119)	(79)	(61)	(55)	(479)

Total BA	(1,235)	(478)	(504)	(521)	(537)	(3,275)
Total O	(1,046)	(520)	(486)	(486)	(494)	(3,032)

US Department of Education

Cost Estimate

The following are loan savings options for FY 98-02. The estimates are based on FY 98 OMB submission volumes and FY 97 MSR interest rates.

FY 98 Budget Options			FY 98	FY 99	FY 00	FY 01	FY 02	FY 98-02	
GA	Increase agency default reinsurance payment to 100%	BA	98	87	93	99	104	481	
		O	60	82	83	89	94	407	
	Reduce agency reserve level to amount needed for 6 months of operations	BA	(1,664)	(12)	0	0	0	(1,676)	
		O	(1,664)	(12)	0	0	0	(1,676)	
	Require lenders to pay guaranty agencies for bringing delinquent loans current	BA	0	0	0	0	0	0	
		O	0	0	0	0	0	0	
	Move administrative cost allowances to the FFEL subsidy	BA	124	111	113	120	127	596	
		O	124	111	113	120	127	596	
	Require periodic recertification of guaranty agencies	BA	0	0	0	0	0	0	
		O	0	0	0	0	0	0	
	GA interactive changes (includes \$600 million in negated FY 97 GA reserve savings and \$264 million in negated FY 97 savings due to the increase of GA reinsurance from 96/86/76 to 100%)	BA	173	169	171	174	177	864	
		O	153	165	166	169	172	824	
GA BA			(1,270)	355	377	393	409	264	
GA O			(1,328)	346	362	377	393	150	
Lender	Set in-school interest rate at the government borrowing rate	BA	(256)	(176)	(186)	(194)	(205)	(1,017)	
		O	(140)	(188)	(165)	(173)	(182)	(848)	
	Require lenders to offer same repayment plans available under Direct Loans	BA	(201)	(194)	(203)	(215)	(229)	(1,043)	
		O	(87)	(173)	(174)	(183)	(195)	(812)	
	Remove limitation on authority to make FISL program loans	BA	0	0	0	0	0	0	
		O	0	0	0	0	0	0	
	Eliminate special allowance payments for all new loans	BA	0	0	0	0	0	0	
		O	0	0	0	0	0	0	
	Lender interactive changes (includes \$962 million in FY 97 negated lender savings)	BA	196	172	190	199	206	962	
		O	119	162	167	178	186	812	
	Lender BA			(261)	(198)	(199)	(211)	(228)	(1,097)
	Lender O			(109)	(199)	(172)	(178)	(191)	(848)
Student	Reduce Direct Loan origination fee by 1%	BA	176	203	215	227	240	1,059	
		O	95	171	187	198	209	860	
	Eliminate the 1% borrower insurance fee	BA	0	0	0	0	0	0	
		O	0	0	0	0	0	0	

Require SSA and INS matches for PLUS applicants	BA	(1)	(1)	(1)	(1)	(1)	(5)
	O	(1)	(1)	(1)	(1)	(1)	(5)
Allow use of FAFSA as FFEL application	BA	0	0	0	0	0	0
	O	0	0	0	0	0	0
Allow FFEL consolidators to retain Stafford interest subsidies benefits (\$0 savings assumes that all consolidations occur after entering repayment; option costs \$490 million if consolidations occur in the in-	BA	0	0	0	0	0	0
	O	0	0	0	0	0	0
Standardize Consolidation loan interest rates on Direct Loan formula	BA	0	0	0	0	0	0
	O	0	0	0	0	0	0
Deny eligibility to consolidate certain defaulters	BA	0	0	0	0	0	0
	O	0	0	0	0	0	0
Allow FFEL consolidators to reconsolidate to add previous loans after the 180 day window	BA	0	0	0	0	0	0
	O	0	0	0	0	0	0

Student BA	175	202	214	226	239	1,054
Student O	94	170	186	197	208	855

School Eliminate improper servicing as grounds for appeal of cohort default sanctions	BA	0	0	0	0	0	0
	O	0	0	0	0	0	0

School BA	0	0	0	0	0	0
School O	0	0	0	0	0	0

Admin Move administrative cost allowance to the FFEL subsidy	BA	(124)	(111)	(113)	(120)	(127)	(596)
	O	(124)	(111)	(113)	(120)	(127)	(596)

Admin BA	(124)	(111)	(113)	(120)	(127)	(596)
Admin O	(124)	(111)	(113)	(120)	(127)	(596)

Total BA	(1,479)	247	278	288	293	(374)
Total O	(1,466)	206	263	276	282	(439)

FY 1998 President's Budget

Policy Options for Student Loan Programs

Policies Affecting Guaranty Agencies

	<u>FY 1998</u>	<u>FY 1999</u>	<u>FY 2000</u>	<u>FY 2001</u>	<u>FY 2002</u>	<u>FY 98-02</u>
<u>FY 1998 Policies</u>						
Eliminate Supplemental PreClaims Assistance (From FY 1997)						
BA	(70)	(9)	(10)	(10)	(10)	(109)
Outlays	(66)	(9)	(9)	(9)	(9)	(102)
Reduce Default Collection Retention to 18.5 Percent (From FY 1997)						
BA	(279)	(34)	(36)	(37)	(39)	(425)
Outlays	(263)	(31)	(31)	(33)	(35)	(393)
Reduce Agency Reserve Level to 6 Months Working Capital						
BA	(1,664)	(12)	-	-	-	(1,676)
Outlays	(1,664)	(12)	-	-	-	(1,676)
Increase Default Reinsurance Payment to 100 Percent						
BA	98	87	93	99	104	481
Outlays	60	82	83	89	94	407
Move Administrative Cost Allowances to FFEL Subsidy						
BA	124	111	113	120	127	596
Outlays	124	111	113	120	127	596
Require Lenders to Pay Agency Default Prevention Fee						
BA	-	-	-	-	-	-
Outlays	-	-	-	-	-	-
Require Periodic Agency Recertification						
BA	-	-	-	-	-	-
Outlays	-	-	-	-	-	-
<u>FY 1997 Policies Dropped for FY 1998</u>						
Reduce Reinsurance Rate to 96/86/76						
BA	(53)	(49)	(51)	(54)	(57)	(264)
Outlays	(33)	(45)	(46)	(49)	(52)	(225)
Pay Agencies 18.5% on Consolidations of Defaults						
BA	-	-	-	-	-	-
Outlays	-	-	-	-	-	-
Recall Portion of Unneeded Agency Reserve Funds						
BA	(120)	(120)	(120)	(120)	(120)	(600)
Outlays	(120)	(120)	(120)	(120)	(120)	(600)
<u>Net GA-Related Savings</u>						
BA	(1,791)	143	160	172	182	(1,133)
Outlays	(1,809)	141	156	166	177	(1,169)

Policies Affecting Lenders, Loan Holders, and the Secondary Market

	<u>FY 1998</u>	<u>FY 1999</u>	<u>FY 2000</u>	<u>FY 2001</u>	<u>FY 2002</u>	<u>FY 98-02</u>
<u>FY 1998 Policies</u>						
Extend Sallie Mae Fee to Entire Secondary Market (From FY 1997)						
BA	(298)	(36)	(39)	(41)	(43)	(458)
Outlays	(281)	(33)	(34)	(36)	(38)	(422)
Set In-School Interest Rate at Government Borrowing Rate						
BA	(256)	(176)	(186)	(194)	(205)	(1,017)
Outlays	(140)	(188)	(165)	(173)	(182)	(848)
Require Lenders to Offer Direct Loan Repayment Plans						
BA	(201)	(194)	(203)	(215)	(229)	(1,043)
Outlays	(87)	(173)	(174)	(183)	(195)	(812)
Eliminate Special Allowance for All New Loans						
BA	-	-	-	-	-	-
Outlays	-	-	-	-	-	-
Remove Limitation on Authority to Make FISL Program Loans						
BA	-	-	-	-	-	-
Outlays	-	-	-	-	-	-
<u>FY 1997 Policies Dropped for FY 1998</u>						
Create Semi-Annual Loan Holder Fee						
BA	(59)	(56)	(59)	(62)	(65)	(301)
Outlays	(32)	(51)	(52)	(55)	(57)	(247)
Increase Lender Origination Fee from .5% to .8%						
BA	(58)	(44)	(54)	(56)	(56)	(268)
Outlays	(37)	(44)	(46)	(51)	(52)	(231)
Reduce Lender Reinsurance Rate from 98% to 95%						
BA	(80)	(72)	(77)	(80)	(85)	(394)
Outlays	(49)	(67)	(69)	(72)	(77)	(334)
<u>Net Lender, Holder, Secondary Market-Related Savings</u>						
BA	(755)	(406)	(428)	(451)	(478)	(2,518)
Outlays	(508)	(394)	(373)	(392)	(415)	(2,082)

Policies Affecting Borrowers

	<u>FY 1998</u>	<u>FY 1999</u>	<u>FY 2000</u>	<u>FY 2001</u>	<u>FY 2002</u>	<u>FY 98-02</u>
<u>FY 1998 Policies</u>						
Reduce Direct Loan Origination Fee by 1%						
BA	176	203	215	227	240	1,059
Outlays	95	171	187	198	209	860
Eliminate 1% Borrower Insurance Fee						
BA	-	-	-	-	-	-
Outlays	-	-	-	-	-	-
Standardize Consolidation Interest Rates on Direct Loan Formula						
BA	-	-	-	-	-	-
Outlays	-	-	-	-	-	-
Allow FFEL Consolidators to Retain Stafford Interest Benefits						
BA	-	-	-	-	-	-
Outlays	-	-	-	-	-	-
Allow Use of FAFSA as FFEL Application						
BA	-	-	-	-	-	-
Outlays	-	-	-	-	-	-
Require SSA, INS Matches for PLUS Applicants						
BA	(1)	(1)	(1)	(1)	(1)	(5)
Outlays	(1)	(1)	(1)	(1)	(1)	(5)
Deny Eligibility to Consolidate to Certain Defaulters						
BA	-	-	-	-	-	-
Outlays	-	-	-	-	-	-
Allow FFEL Consolidators to Reconsolidate Previous Loans						
BA	-	-	-	-	-	-
Outlays	-	-	-	-	-	-
<u>FY 1997 Policies Dropped for FY 1998</u>						
Limit PLUS Borrowing to \$15,000 Annually						
BA	-	-	-	-	-	-
Outlays	-	-	-	-	-	-
<u>Net Borrower-Related Costs</u>						
BA	175	202	214	226	239	1,054
Outlays	94	170	186	197	208	855

Policies Affecting Schools

	<u>FY 1998</u>	<u>FY 1999</u>	<u>FY 2000</u>	<u>FY 2001</u>	<u>FY 2002</u>	<u>FY 98-02</u>
<u>FY 1998 Policies</u>						
Eliminate Improper Servicing as Grounds for Appeal of Default Sanctions						
BA	-	-	-	-	-	-
Outlays	-	-	-	-	-	-
<u>Net School-Related Costs</u>						
BA	-	-	-	-	-	-
Outlays	-	-	-	-	-	-

Policies Affecting the Department of Education

	<u>FY 1998</u>	<u>FY 1999</u>	<u>FY 2000</u>	<u>FY 2001</u>	<u>FY 2002</u>	<u>FY 98-02</u>
<u>FY 1998 Policies</u>						
Reduce Administrative Spending Under Section 458 (From FY 1997)						
BA	(218)	(58)	(59)	(60)	(61)	(456)
Outlays	(165)	(119)	(79)	(61)	(55)	(479)
Move Administrative Cost Allowances to FFEL Subsidy						
BA	(124)	(111)	(113)	(120)	(127)	(596)
Outlays	(124)	(111)	(113)	(120)	(127)	(596)
<u>Net Department of Education-Related Costs</u>						
BA	(342)	(169)	(172)	(180)	(188)	(1,052)
Outlays	(289)	(230)	(192)	(181)	(182)	(1,075)
Total Savings (From FY 1997 Baseline)						
BA	(2,713)	(230)	(226)	(233)	(245)	(3,648)
Outlays	(2,512)	(313)	(223)	(210)	(212)	(3,471)