

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: Domestic Policy Council

Series/Staff Member: Bill Galston

Subseries:

OA/ID Number: 5735

FolderID:

Folder Title:

[Direct Lending - March 1993] [Folder 2]

Stack:

S

Row:

95

Section:

6

Shelf:

5

Position:

3

WILLIAMS & ANDERSON

TWENTY-SECOND FLOOR
111 CENTER STREET
LITTLE ROCK, ARKANSAS 72201

W. JACKSON WILLIAMS

(501) 372-0800

TELECOPIER
(501) 372-6453

March 4, 1993

Mr. Bill Galston
Deputy for Domestic Policy
West Wing
The White House
1600 Pennsylvania Avenue, N.W.
Washington, D. C. 20500

HAND DELIVERY

Re: Education Finance Council - Student Loan Program
National Service Administrative System

Dear Bill:

On behalf of the Education Finance Council we are submitting for your consideration a proposal for an administrative system for the National Service initiative proposed by the President.

Basically, this model relies on existing facilities and resources that are currently available at the state level to implement this portion of National Service.

As noted, some 27 states currently serving 71% of all the nation's full-time undergraduate students currently have workable procedures in place for administering loan forgiveness. It is not a difficult transition to modify loan forgiveness to an income contingency plan for loan repayment. Those states which currently do not have workable procedures in place could readily adopt them when mandated by federal legislation requirements to administer National Service program.

We would be pleased to provide you with legislative language incorporating these or similar concepts if you would find that useful.

WILLIAMS & ANDERSON

March 4, 1993
Page Two

We appreciate very much your willingness to visit with us the other day and we look forward to an opportunity to continue our participation as the National Service initiative is put in place.

With best personal regards, I am

Cordially,

WILLIAMS & ANDERSON

A handwritten signature in cursive script, appearing to read "Jack", written in dark ink.

W. Jackson Williams

WJW:js
Enclosure
cc: Mr. Preston Woodruff
Mr. Bill Sanda

A public-private link on student aid

By Daniel S. Cheever Jr.

National service has become a signature issue for the new administration, and specifics are now emerging on exactly how President Clinton will set about, on a practical basis, to pay for and administer his National Service Initiative and to link it with college aid.

While details have not yet been offered, President Clinton this week spoke of scrapping the federally guaranteed loan programs (financed with private dollars) in favor of a model financed directly by the U.S. Treasury. He said repayments would be income-contingent, collected through the federal income tax system. The new president has also spoken more than once about eliminating financial barriers to post-secondary education, and about providing universal access to education loan funds.

Early editions of Clinton's proposal were major applause-getters. No wonder. College costs have exceeded both growth in family income and the inflation rate for the last 20 years. The financial crisis facing American higher education can be seen starkly by calculating the bills that today's kindergarteners will receive when they enroll in college. Assuming an 8 percent annual growth in tuition and fees (the average over the last two decades), the families of these tots can expect to pay \$200,000 for four years at a typical private institution and \$75,000 at a public university. At the expensive private colleges, the total tab will surpass \$300,000.

Given these numbers, President Clinton's concern about the adequacy of federal student aid programs is well-founded. Ironically, however, for all Clinton's talk about universal access to student loans, the 1992 election came on the heels of a truly dramatic federal expansion of the student-loan programs, which are expected to double in size to almost \$30 billion annually by 1998.

These numbers represent an unprecedented level of federal support for middle- and upper middle-income students and families. Under the new law, parents can borrow whatever their child can't, and formerly ineligible middle-income students are now qualified, as long as they take responsibility for in-school interest payments.

The current loan programs deliver about \$15 billion of private lender capital to 5 million students each year. The federal government backs the loans in the event of default and makes interest payments on behalf of students when they are in school. For every federal dollar spent in the program, roughly three are generated for college students. Administrative costs and duties, including loan servicing, are absorbed by lenders and state guarantors. It is a public-private partnership that can be improved, but has worked well over nearly 30 years.

Daniel S. Cheever Jr. is president of American Student Assistance, a student-loan guarantor, and former president of Wheelock College in Boston.

President Clinton seems prepared to present legislation that would require the U.S. Treasury to provide the money instead. The General Accounting Office has argued that direct lending would save over \$4 billion during the next five years, assuming the Department of Education can manage it. But the Congressional Research Service sent Capitol Hill a report last week stating that such "savings" amount to "no more than the failure of federal bookkeeping to record outlays for taxpayers' absorption of risk." Finally, the department's own inspector general testified in the House two weeks ago that the department couldn't manage direct lending without large funding increases.

If there was a clear message in the recent election, it was that the public understands the threat posed by the federal deficit and wants it reduced. However, President Clinton can achieve many of his aims—and likely at lower cost to the taxpayer—within the framework of the current public-private system, particularly in light of last year's reauthorization of the Higher Education Act. Changes in that legislation will test many of Clinton's ideas, among them direct loans to students.

At the urging of some, but by no means all, post-secondary institutions, Congress agreed to approve a four-year pilot program through which direct federal loans will be made to students at hundreds of colleges and universities across the country. The U.S. Department of Education has begun planning for this test, which starts next year. If the test shows us that direct loans are a simpler, less expensive way to distribute funds, and if the Department can manage it successfully, then it should be phased in to replace the current system. Failure to test direct lending beforehand could have disastrous results on the flow of billions of dollars in student-loan funds.

Income-contingent and income-sensitive repayment of loans will also be tested under recent changes in the law. These provide students with an opportunity to limit early monthly loan burdens when their wages and salary are low. While some borrowers may prefer to have loan payments deducted from paychecks, along with FICA, Social Security and state taxes, many more of them have been content to retire their loans with a payment booklet on a 10- or 15-year schedule. The administration should also evaluate carefully the record of the Income Contingent Loan Program attempted in the 1980s, which was phased out after administrative snags and a lack of student interest.

Finally, as various financial players in the student loan program make their case for continued participation, President Clinton should call their bluff by asking them to share the burden of paying for and administering his important National Service Initiative. Guarantors and the financial participants in the student loan programs represent a national infrastructure tailor-made for the decentralized administration of national and community service, either pre- or post-college. The president and Congress should ask more of this public-private partnership before setting up another Washington bureaucracy to process thousands or millions of national service vouchers.

Chicago Tribune - March 3, 1993

NATIONAL SERVICE ADMINISTRATIVE SYSTEM

As President Clinton moves forward with his plans to implement his National Service Initiative, one of the most difficult tasks initially will be deciding how to administer the program, including tracking the loans to be forgiven. Using existing experience and capacities of the public-private education financing partnership to administer the new initiative could save the Federal government tens of millions of dollars in administrative expenses and obviate the necessity of hiring large numbers of federal employees at the same time the government is trying to reduce the federal bureaucracy.

The following is a brief analysis of programs that could assist the President in implementing his National Service Initiative and a discussion of other resources that could be marshalled at the state level to ease implementation of the program. The following areas are specifically addressed:

- Existing expertise with state and federal loan forgiveness programs;
- Non-federal resources that could be dedicated to the National Service Initiative; and
- A potential model for administering and delivering the National Service Initiative.

EXISTING EXPERTISE WITH STATE AND FEDERAL LOAN FORGIVENESS PROGRAMS

Student loan forgiveness, a key element of the National Service Initiative, has been in place, in one form or another, for 35 years. Beginning with the enactment of the National Defense Student Loan program in 1958, participants in student loan programs have been building expertise in delivering Federal loan forgiveness programs. Loan forgiveness options have been offered through the military and the Department of Health and Human Services, as well as through the Department of Education. Specific program examples include: nursing and military service programs offering forgiveness for all federal loan programs; the Perkins Loan program, which provides loan forgiveness for teachers and law enforcement officers; and the Health Education Assistance Loans and National Health Service Corps Scholarships, which offer loan forgiveness in return for service.

Several states, through their guaranty agencies or grant programs, also operate state loan forgiveness programs. California, Florida, New York, Georgia, Illinois, Pennsylvania, Idaho, Iowa, Maryland and Washington currently have various types of operational loan forgiveness programs. Each of these states have tracking and loan forgiveness processes in place. Several other states maintain direct lending programs in which they hold all the loans for students and could easily monitor loans and administer forgiveness programs.

Twenty-seven states, serving 71 percent of all the nation's full-time undergraduate students, have workable procedures in place that would allow them to assume the responsibilities of administering the loan forgiveness portion of the National Service Initiative. Other states, through their state guaranty agencies, could easily adopt procedures from the 27 states for implementing loan forgiveness programs. Most importantly for the Federal government, there would be no additional costs or personnel needs for the government to assume, since the work would be performed by employees of existing state or non-for-profit entities.

NON-FEDERAL RESOURCES THAT COULD BE DEDICATED TO THE NATIONAL SERVICE INITIATIVE

Ongoing programs at the state level could become a vehicle for administering the National Service Initiative. State secondary markets routinely purchase loans from lenders to replenish the lenders' supply of money that can be loaned to other borrowers. State guaranty agencies also buy guaranteed student loans from lenders and assume responsibility for maintaining them as part of the loan default process. When a guaranteed student loan goes into default, the guaranty agency that insures the loan pays the lender an amount equal to its remaining balance and in return receives ownership of the loan. This process of purchasing loans could be used for loans to students who opt for National Service repayment provisions.

Existing guaranty agencies or state secondary markets could enter into contracts with the federal government to purchase student loans when a student designates his or her desire to use national service to pay a portion of the loan. They could then receive payments from the federal government to credit to the student's account, as well as collect on the remaining balance of the loan. Having the program state centered will make contact with the borrower easier and facilitate tracking the loan and the national service components of the program.

Many state agencies also operate state college work study programs where they track and pay students for work. Their processes are very similar to those needed for the National Service Initiative.

POTENTIAL MODELS FOR ADMINISTERING AND DELIVERING THE NATIONAL SERVICE INITIATIVE

Model I. The following is a possible model for how the National Service Initiative could work for students who already have loans, utilizing existing programs and processes in the student aid industry.

- STEP 1. Borrowers will file an application for loan forgiveness with the administrator for National Service (guaranty agency or state secondary market, designated by the Secretary) in their state.
- STEP 2. The administrator will identify who is holding their loans.

- STEP 3. The administrator will verify the borrowers are meeting the requirements of the program.
- STEP 4. The administrator will either purchase the loan or become the intermediary for the loan with the federal government.
- STEP 5. The federal government, based on information provided by the administrator, will issue a payment to be credited to the loan to the administrator.

Model II. A similar model, also utilizing guaranty agencies or state secondary markets, can be designed for students who wish to acquire community service credit before they enter higher education or during their postsecondary education experience.

- STEP 1. Individuals wanting to earn vouchers from the National Service Initiative, before or during their postsecondary education experience, will submit an application to the administrator for national service.
- STEP 2. The administrator will verify that the potential national service job meets the requirements of the National Service Initiative.
- STEP 3. The administrator will verify the individuals are meeting the requirements of the program.
- STEP 4. The administrator will update the federal government on the amount of credit earned by the individual; so vouchers can be created for the individual.
- STEP 5. When a borrower who has previously earned National Service vouchers enters repayment on a loan, he or she will contact the administrator who will contact the federal government so it can make a payment on the loan equal to the amount earned by the student.

NATIONAL SERVICE ADMINISTRATIVE SYSTEM

As President Clinton moves forward with his plans to implement his National Service Initiative, one of the most difficult tasks initially will be deciding how to administer the program, including tracking the loans to be forgiven. Using existing experience and capacities of the public-private education financing partnership to administer the new initiative could save the Federal government tens of millions of dollars in administrative expenses and obviate the necessity of hiring large numbers of federal employees at the same time the government is trying to reduce the federal bureaucracy.

The following is a brief analysis of programs that could assist the President in implementing his National Service Initiative and a discussion of other resources that could be marshalled at the state level to ease implementation of the program. The following areas are specifically addressed:

- Existing expertise with state and federal loan forgiveness programs;
- Non-federal resources that could be dedicated to the National Service Initiative; and
- A potential model for administering and delivering the National Service Initiative.

EXISTING EXPERTISE WITH STATE AND FEDERAL LOAN FORGIVENESS PROGRAMS

Student loan forgiveness, a key element of the National Service Initiative, has been in place, in one form or another, for 35 years. Beginning with the enactment of the National Defense Student Loan program in 1958, participants in student loan programs have been building expertise in delivering Federal loan forgiveness programs. Loan forgiveness options have been offered through the military and the Department of Health and Human Services, as well as through the Department of Education. Specific program examples include: nursing and military service programs offering forgiveness for all federal loan programs; the Perkins Loan program, which provides loan forgiveness for teachers and law enforcement officers; and the Health Education Assistance Loans and National Health Service Corps Scholarships, which offer loan forgiveness in return for service.

Several states, through their guaranty agencies or grant programs, also operate state loan forgiveness programs. California, Florida, New York, Georgia, Illinois, Pennsylvania, Idaho, Iowa, Maryland and Washington currently have various types of operational loan forgiveness programs. Each of these states have tracking and loan forgiveness processes in place. Several other states maintain direct lending programs in which they hold all the loans for students and could easily monitor loans and administer forgiveness programs.

Twenty-seven states, serving 71 percent of all the nation's full-time undergraduate students, have workable procedures in place that would allow them to assume the responsibilities of administering the loan forgiveness portion of the National Service Initiative. Other states, through their state guaranty agencies, could easily adopt procedures from the 27 states for implementing loan forgiveness programs. Most importantly for the Federal government, there would be no additional costs or personnel needs for the government to assume, since the work would be performed by employees of existing state or non-for-profit entities.

NON-FEDERAL RESOURCES THAT COULD BE DEDICATED TO THE NATIONAL SERVICE INITIATIVE

Ongoing programs at the state level could become a vehicle for administering the National Service Initiative. State secondary markets routinely purchase loans from lenders to replenish the lenders' supply of money that can be loaned to other borrowers. State guaranty agencies also buy guaranteed student loans from lenders and assume responsibility for maintaining them as part of the loan default process. When a guaranteed student loan goes into default, the guaranty agency that insures the loan pays the lender an amount equal to its remaining balance and in return receives ownership of the loan. This process of purchasing loans could be used for loans to students who opt for National Service repayment provisions.

Existing guaranty agencies or state secondary markets could enter into contracts with the federal government to purchase student loans when a student designates his or her desire to use national service to pay a portion of the loan. They could then receive payments from the federal government to credit to the student's account, as well as collect on the remaining balance of the loan. Having the program state centered will make contact with the borrower easier and facilitate tracking the loan and the national service components of the program.

Many state agencies also operate state college work study programs where they track and pay students for work. Their processes are very similar to those needed for the National Service Initiative.

POTENTIAL MODELS FOR ADMINISTERING AND DELIVERING THE NATIONAL SERVICE INITIATIVE

Model I. The following is a possible model for how the National Service Initiative could work for students who already have loans, utilizing existing programs and processes in the student aid industry.

- STEP 1. Borrowers will file an application for loan forgiveness with the administrator for National Service (guaranty agency or state secondary market, designated by the Secretary) in their state.
- STEP 2. The administrator will identify who is holding their loans.

- STEP 3. The administrator will verify the borrowers are meeting the requirements of the program.
- STEP 4. The administrator will either purchase the loan or become the intermediary for the loan with the federal government.
- STEP 5. The federal government, based on information provided by the administrator, will issue a payment to be credited to the loan to the administrator.

Model II. A similar model, also utilizing guaranty agencies or state secondary markets, can be designed for students who wish to acquire community service credit before they enter higher education or during their postsecondary education experience.

- STEP 1. Individuals wanting to earn vouchers from the National Service Initiative, before or during their postsecondary education experience, will submit an application to the administrator for national service.
- STEP 2. The administrator will verify that the potential national service job meets the requirements of the National Service Initiative.
- STEP 3. The administrator will verify the individuals are meeting the requirements of the program.
- STEP 4. The administrator will update the federal government on the amount of credit earned by the individual; so vouchers can be created for the individual.
- STEP 5. When a borrower who has previously earned National Service vouchers enters repayment on a loan, he or she will contact the administrator who will contact the federal government so it can make a payment on the loan equal to the amount earned by the student.

NATIONAL SERVICE ADMINISTRATIVE SYSTEM

As President Clinton moves forward with his plans to implement his National Service Initiative, one of the most difficult tasks initially will be deciding how to administer the program, including tracking the loans to be forgiven. Using existing experience and capacities of the public-private education financing partnership to administer the new initiative could save the Federal government tens of millions of dollars in administrative expenses and obviate the necessity of hiring large numbers of federal employees at the same time the government is trying to reduce the federal bureaucracy.

The following is a brief analysis of programs that could assist the President in implementing his National Service Initiative and a discussion of other resources that could be marshalled at the state level to ease implementation of the program. The following areas are specifically addressed:

- Existing expertise with state and federal loan forgiveness programs;
- Non-federal resources that could be dedicated to the National Service Initiative; and
- A potential model for administering and delivering the National Service Initiative.

EXISTING EXPERTISE WITH STATE AND FEDERAL LOAN FORGIVENESS PROGRAMS

Student loan forgiveness, a key element of the National Service Initiative, has been in place, in one form or another, for 35 years. Beginning with the enactment of the National Defense Student Loan program in 1958, participants in student loan programs have been building expertise in delivering Federal loan forgiveness programs. Loan forgiveness options have been offered through the military and the Department of Health and Human Services, as well as through the Department of Education. Specific program examples include: nursing and military service programs offering forgiveness for all federal loan programs; the Perkins Loan program, which provides loan forgiveness for teachers and law enforcement officers; and the Health Education Assistance Loans and National Health Service Corps Scholarships, which offer loan forgiveness in return for service.

Several states, through their guaranty agencies or grant programs, also operate state loan forgiveness programs. California, Florida, New York, Georgia, Illinois, Pennsylvania, Idaho, Iowa, Maryland and Washington currently have various types of operational loan forgiveness programs. Each of these states have tracking and loan forgiveness processes in place. Several other states maintain direct lending programs in which they hold all the loans for students and could easily monitor loans and administer forgiveness programs.

1

Twenty-seven states, serving 71 percent of all the nation's full-time undergraduate students, have workable procedures in place that would allow them to assume the responsibilities of administering the loan forgiveness portion of the National Service Initiative. Other states, through their state guaranty agencies, could easily adopt procedures from the 27 states for implementing loan forgiveness programs. Most importantly for the Federal government, there would be no additional costs or personnel needs for the government to assume, since the work would be performed by employees of existing state or non-for-profit entities.

NON-FEDERAL RESOURCES THAT COULD BE DEDICATED TO THE NATIONAL SERVICE INITIATIVE

Ongoing programs at the state level could become a vehicle for administering the National Service Initiative. State secondary markets routinely purchase loans from lenders to replenish the lenders' supply of money that can be loaned to other borrowers. State guaranty agencies also buy guaranteed student loans from lenders and assume responsibility for maintaining them as part of the loan default process. When a guaranteed student loan goes into default, the guaranty agency that insures the loan pays the lender an amount equal to its remaining balance and in return receives ownership of the loan. This process of purchasing loans could be used for loans to students who opt for National Service repayment provisions.

Existing guaranty agencies or state secondary markets could enter into contracts with the federal government to purchase student loans when a student designates his or her desire to use national service to pay a portion of the loan. They could then receive payments from the federal government to credit to the student's account, as well as collect on the remaining balance of the loan. Having the program state centered will make contact with the borrower easier and facilitate tracking the loan and the national service components of the program.

Many state agencies also operate state college work study programs where they track and pay students for work. Their processes are very similar to those needed for the National Service Initiative.

POTENTIAL MODELS FOR ADMINISTERING AND DELIVERING THE NATIONAL SERVICE INITIATIVE

Model I. The following is a possible model for how the National Service Initiative could work for students who already have loans, utilizing existing programs and processes in the student aid industry.

- STEP 1. Borrowers will file an application for loan forgiveness with the administrator for National Service (guaranty agency or state secondary market, designated by the Secretary) in their state.
- STEP 2. The administrator will identify who is holding their loans.

- STEP 3. The administrator will verify the borrowers are meeting the requirements of the program.
- STEP 4. The administrator will either purchase the loan or become the intermediary for the loan with the federal government.
- STEP 5. The federal government, based on information provided by the administrator, will issue a payment to be credited to the loan to the administrator.

Model II. A similar model, also utilizing guaranty agencies or state secondary markets, can be designed for students who wish to acquire community service credit before they enter higher education or during their postsecondary education experience.

- STEP 1. Individuals wanting to earn vouchers from the National Service Initiative, before or during their postsecondary education experience, will submit an application to the administrator for national service.
- STEP 2. The administrator will verify that the potential national service job meets the requirements of the National Service Initiative.
- STEP 3. The administrator will verify the individuals are meeting the requirements of the program.
- STEP 4. The administrator will update the federal government on the amount of credit earned by the individual; so vouchers can be created for the individual.
- STEP 5. When a borrower who has previously earned National Service vouchers enters repayment on a loan, he or she will contact the administrator who will contact the federal government so it can make a payment on the loan equal to the amount earned by the student.



UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF THE SECRETARY

~~CONFIDENTIAL~~

DETERMINED TO BE AN
ADMINISTRATIVE MARKING

INITIALS: JAM DATE: 10/2/2017
2017-1069-F

PURPOSE: INFORMATION
FOR MEETING WITH PRESIDENT
DAY: Friday
DATE: March 5, 1993
TIME: 5:00 pm

MEMORANDUM

TO : The President

FROM : Secretary Dick Riley *Dick Riley*

SUBJECT : Options for National Service and Student Aid Reform

This memorandum seeks your guidance on how far to move in the direction of reforming the federal student aid system as part of your efforts to encourage national service and make college more affordable. The mandate for national service offers a window of opportunity to restructure the student aid programs as well.

This memorandum asks for your decisions on three issues related to the national service initiative and student aid reform:

- o How broad should student aid reform be?
- o How can we best provide student loans at a substantially reduced federal cost?
- o How can we best structure student loan repayments, including income contingent repayments, to allow students to take lower paying public service jobs?

We met Wednesday with a group, including White House and OMB staff and several outside experts, to discuss the options presented in the attached paper. Also attached is a list of participants who attended this meeting.

- o All participants thought that federal funds should be the source of capital for student lending since federal funds are less expensive than private funds.
- o Broad consensus existed that a direct loan system should build on the strengths of the existing system to enable us to move immediately to a form of direct lending that can work for all postsecondary institutions, including proprietary schools. Continuing the current system intact but trying to remove excess profits would not be a successful approach.

Page 2 - The President

- o Everyone believed that we should provide borrowers with a range of flexible repayment options, including income contingent repayments, rather than requiring all borrowers to repay through income contingency. Borrowers could then choose the option that best suited them.

I agree with the above discussion. Should you also agree, there are still several outstanding issues.

- o How broad should your student aid reform package be? The group generally agreed that a comprehensive strategy for reform of student aid would be preferable. It would fix the fundamental problems with the current system. This strategy has major political downsides, however, and could detract attention from national service.
- o Who should service and collect student loans? Should different organizations be responsible for servicing and collecting loans under different repayment options? What is the role of the IRS?

The attached paper discusses these issues in more detail. The paper first addresses the overall strategy problem (Decision 1). It then considers key issues regarding the reform of student loans: the development of a direct loan program (Decision 2) and repayment issues including income contingency and IRS collection (Decision 3). I have made recommendations on each of these issues. I look forward to talking with you about them.

Attachments: Paper on National Service and Student Aid Reform
 List of Participants at Secretary Riley's Meeting on National Service and
 Student Aid Reform - March 3, 1993
 Briefing Book (background information on student aid issues)

PAPER ON NATIONAL SERVICE AND STUDENT AID REFORM

DECISION 1: CHOOSING A BROAD STRATEGY

Your campaign focused on two goals related to national service and improved college access.

- o Developing a student loan repayment system that would sharply reduce defaults and would alleviate borrowers' worries about repayment if they took low-paying jobs.
- o Improving the student aid programs, which are costly to the federal government and complicated and confusing for students and their families.

Three strategies are suggested below that, in combination with national service, would achieve these objectives to varying degrees. Each of the three strategies builds on the previous one, with the third being the most comprehensive.

Strategy One: Focus on student loan reforms. This approach would:

- o Reform the student loan programs to reduce federal costs.
- o Provide income-contingent repayment and possibly other repayment options for all student loan borrowers.
- o Reward national service through loan forgiveness.

This strategy could reduce federal costs substantially by reforming the student loan programs, but it would not make the current system appreciably more understandable to students and parents. This strategy could successfully provide a system of loan repayments so that debt would not prevent student borrowers from taking lower paying, public service jobs. Specific options on how to reduce federal costs and improve repayment mechanisms are presented in Decisions 2 and 3.

Strategy Two: Reform other parts of the student aid system as well as loans. The main components of this approach would:

- o Introduce more predictability into the student aid programs by creating an overall federal aid maximum. This approach, recently recommended by a bipartisan commission, would make all students eligible for a particular amount of aid each year--the lesser of school costs or \$10,000, for example. The mix of aid among grants, subsidized loans, and unsubsidized loans would vary depending on the student's family income. This level could push up tuitions at less expensive institutions but might provide a modest form of cost containment for more expensive institutions since aid limits and tuition decisions would be severed.

Broad consensus exists in the higher education community that this approach would be desirable. It would make student aid more predictable, clear and simple.

- o Another matter for consideration is whether we should refocus the Pell Grant program so that it better serves students and brings federal costs under control. The recent reauthorization expanded eligibility so that it will be difficult to fund substantial increases in the maximum grant limits. Changes in the Pell Grant program could be controversial because some students would lose eligibility. I suggest that we conduct a careful analysis of ways to make the Pell Grant program consistent with the plan to provide a predictable amount of aid to all students. We would be happy to conduct this analysis and develop specific recommendations.
- o Streamline and consolidate all student aid programs so that they are easier to understand for students and their families. We have a variety of ideas about how to do this.

Strategy Two would move closer to addressing your goal of reforming and simplifying the entire student aid system. It would make the amount of aid more predictable and the system simpler and more understandable for students and their families.

Strategy Three: Explore better ways to finance postsecondary vocational training, particularly proprietary (profit-making) schools. One possible way to do this might be to:

- o Move the primary responsibility for financing vocational training from Department of Education student aid programs to Department of Labor job training and apprenticeship programs. Moving proprietary training programs to Labor would increase the practice of holding institutions accountable to outcome standards in this field since Labor training programs include some outcome standards, which the student aid programs do not.

Such a strategy would address one of the most vexing aspects of the current student aid system in which aid is used to pay for short-term training at profit-making institutions. Currently, one-quarter of Pell Grant dollars and about one-third of student loan dollars go to individuals attending proprietary trade schools. Borrowers from proprietary schools are four times more likely to default than students from four-year colleges and universities. In addition, institutional abuses of the student aid programs have been prevalent at proprietary institutions.

This matter has not been discussed with Labor and no recommendation has been included here. We could explore this further with Labor and develop recommendations if you wish.

Discussion

Taking a more comprehensive approach, as outlined in strategies two and three, would address many major problems in the current student aid system. The climate for larger changes is quite possible this year given your new administration and the dissatisfaction among some with last year's reauthorization changes. However, some others may resist more comprehensive reform, particularly the third option.

Massive restructuring of the student aid system may detract political attention from national service. On the other hand, these changes could reach all students and create more access to college and public service jobs. The desire to move quickly on national service and its high visibility could help to make comprehensive reform more possible. The more comprehensive your approach to student aid reform, the more you will leave your mark on the system and the more that you will achieve your campaign objectives.

RECOMMENDATION FOR DECISION 1: I recommend that you adopt strategy one and at least part of strategy two to provide a predictable amount of aid to all students. We should also explore ways to refocus the Pell Grant program and ways to better finance short-term job training, especially at proprietary schools. The third option should be explored by the Departments of Education and Labor as we work together to develop strategies for job training.

DECISION 2: REDUCING FEDERAL LOAN COSTS

Reforming student loans should be based on two primary principles:

- o **First, federal funds are the least expensive source of capital for student loans.** Presently, we pay an excessively high rate to lenders for private capital. This difference is the primary source of federal budget savings generated from direct loans. If we eliminate this aspect, much of the potential savings will disappear.
- o **Second, the federal government should not assume direct responsibility for running any specific segments of the student loan system.** Instead, we should opt for a series of public/private partnerships at competitive prices. Each function--such as originating loans, servicing them, and collecting them--should be carried out by the organizations that can best do these activities. This could also provide roles for some of the existing players, but at a much lower price than we currently pay.

Option A: Implement full direct loans. Expanding the direct loan demonstration program now on the books could get us to full direct lending in 1997. This option uses federal capital with schools originating loans. It assumes the elimination of all other players now in the system, such as lenders, Sallie Mae, and guarantee agencies.

- o Full direct lending in this way would simplify the system by eliminating many individual players and would save an estimated \$1.3 billion in FY 1997.
- o Deciding to go to full scale implementation solely through the demonstration program prematurely presumes that this concept does work and that all types of educational institutions will be able to handle the responsibilities entailed in direct lending.
- o There are at least several reasons, however, to believe that some proportion of institutions will not be successful direct lenders because they lack the administrative capability. Others may choose not to participate, especially if no administrative payment is provided to defray the additional costs they incur. To address this issue and the transition from the current system to direct lending requires an alternative mechanism to ensure that all students are still able to borrow.

Option B: Implement direct loans building on the strengths of the current system. Another approach to direct lending is to build on existing programs and institutional actors and allow for different forms of direct lending depending on the capacity of educational institutions. This approach would also use federal funds as the source of capital for student loans.

- o This option would build on existing programs by increasing the size of the direct loan demonstration program; expanding an existing direct loan program, Perkins loans; using other organizations—such as the state agencies, banks, and Sallie Mae—to originate loans for some institutions; and converting current guaranteed loans into direct loans.
- o It would allow us to move more quickly and with fewer risks than the first option. Like the first option, it could save \$1.3 billion in FY 1997. This approach could also include a major role for the states in which they could carry out many functions, including origination, monitoring, servicing, and collections, for the federal government.
- o Increasing the size of the direct loan demonstration program and developing standards to measure the capacity of institutions to handle direct lending will help the Department of Education to structure lending for institutions that don't have adequate resources to handle it directly.

- o Transforming the Perkins Loan program into a direct loan component of the Stafford Loan Program would allow the 3000 institutions that currently participate in the Perkins program to run a full scale direct loan program. Most of the proprietary institutions do not participate in the Perkins program so they would not become direct lenders here. This may be a good idea since they are smaller and tend to have more limited administrative capacities.
- o Designating organizations other than educational institutions to act as loan originators for institutions that are not direct lenders could work well for institutions without the capability to administer direct loans, including proprietary schools. A variety of organizations including banks, state agencies, Sallie Mae, and others could do loan origination for a fee using federal capital.
- o Converting guaranteed loans into direct loans through the government purchase of loans made initially with private capital would allow us to move very quickly and to provide direct loans in the transition period before full implementation of this option.

Option C: Continue the current system intact but remove the excess profits. The current system provides wide access to capital although it does so at a very high price. Using the specter of full direct lending could force lenders to eliminate these excess profits and thereby reduce federal costs. On the other hand, this approach would not address any of the underlying problems in the current student loan programs.

- o Cutting the current return to lenders by 2 percentage points would save almost as much in 1997 as full direct lending. Differences of opinion exist, however, on whether the lenders would participate at this reduced price. Some believe that this payment would be sufficient to assure their continued participation; others believe that banks would stop student lending if its profitability declined. Whatever the specific number of banks which would stop lending, the federal government would need alternatives in place to be sure that access to loan capital did not dry up in certain places or for certain students.

RECOMMENDATION FOR DECISION 2: I recommend the second option because it builds on the existing system and uses several approaches to direct lending. This will enable us to move to a form of direct lending that can work for all postsecondary institutions while saving more than \$1 billion in FY 1997.

DECISION 3: MAKING REPAYMENT EASIER

In designing a repayment system that allows students to repay as a function of their income, two main questions arise: Who should pay through income contingency? Who should collect the loans?

Under income contingency, most, but not all borrowers, would fully repay their loans. Some would not completely repay because their incomes would remain low throughout their lifetimes. The federal government--or taxpayers in general--would repay whatever was not paid. A CBO estimate last year indicated that this would cost the government roughly 5 cents on each dollar loaned, depending on the exact income contingent proposal. This would be about half of current default costs.

Who should repay through income contingent repayments? This system of repayment could be required for all borrowers, or it could be optional for borrowers who choose income contingent repayments.

- o Requiring all borrowers to repay through an income contingent system has the appeal of simplicity because it is applied to all borrowers. On the other hand, it requires that we create a new and costly system for all borrowers, 80 percent of whom have no trouble repaying through current repayment schemes.
- o A second approach would provide borrowers a range of flexible repayment options including fixed repayments, graduated repayments (payments are lower in early years when income tends to be lower and higher in later years when earnings are higher), and income contingent schedules. Borrowers would choose how to repay best their loans depending on their level of debt and income. Defaulters, or those borrowers in danger of defaulting, could be required to repay through income contingency.

Who should collect and service student loans? Full scale income contingency, as discussed above, only makes sense if the IRS does the collection since all borrowers would be repaying on the basis of their income. Under the flexible repayment option, the IRS or some existing student loan organizations such as Sallie Mae or the state guaranty agencies could service and collect loans.

- o The arguments for using the IRS to service and collect student loans based on taxable income are that IRS has the most accurate income information from tax returns and that the IRS has the largest array of enforcement options--sanctions, wage garnishments, etc--available to successfully collect loans.

On the other hand, using the IRS would require major changes to the IRS system, which could take several years and be quite costly. In addition, for the IRS to collect effectively, debt must be legally classified as a tax owed to the federal government, which means that defaulters would be subject to the same laws and penalties used for tax evaders.

How students would pay the IRS is also an issue. If the debt is paid through the W-4 form for withholding, it will be an additional reporting requirement for employers. Business, particularly small business, will likely oppose this and compliance will be more difficult for self employed persons. If, on the other hand, debt is repaid through a lump sum at tax time, it could be a fairly high amount making full compliance problematic.

- o The alternative is for other organizations--such as private firms, Sallie Mae or the state guarantee agencies, for example--to service and collect all student loans, including income contingent repayments. The arguments for using these organizations is that they currently have experience in servicing and collecting, although not income contingent collections. In addition, this approach would not require a new collection system and would not have the negative connotations attached to IRS.

The major drawback is that these organizations would not have as easy access to income information and they would not have the force of the IRS behind them. Getting accurate income information would require either obtaining the information from the IRS or getting it from the borrower. IRS has privacy concerns with giving income information to the Department of Education or its designated collectors, however. Another approach is to require borrowers to provide the information themselves. Reverting to a fixed payment schedule whenever a borrower does not provide the required information would create an incentive for borrowers to provide timely data.

RECOMMENDATION FOR DECISION 3: I recommend the flexible repayment approach rather than requiring income contingent repayments for all borrowers. This allows borrowers the maximum flexibility to choose how to repay.

I also recommend that we continue to explore who should service and collect student loans. We should continue to analyze the feasibility of using IRS to collect student loans with Treasury and other members of your administration.

Attendees
Meeting on Student Aid Reform
Department of Education
March 4, 1993

Secretary Riley

Deputy Secretary Kunin

Maureen McLaughlin, *Acting Assistant Secretary for Postsecondary Education*

Mike Smith, *Consultant and Dean of Stanford School of Education*

Kay Casstevens, *Assistant Secretary Designate for Legislative Affairs*

Billy Webster, *Chief of Staff for Secretary Riley*

Michele Cavataio, *Special Assistant to Deputy Secretary Kunin*

Arthur Hauptman, *Higher Education: Consultant and Author*

Tom Butts, *University of Michigan*

Congressman Robert Andrews

Ken Holdsman, *Legislative Director for Congressman Andrews*

Alice Rivlin, OMB

Barry White, OMB

Barbara Selfridge, OMB

Matthew Miller, OMB

Clarence Crawford, GAO

Linda Morra, GAO

Bill Galston, *Domestic Policy Council*

Gene Sperling, *National Economic Council*

Ellen Sideman, *National Economic Council*

March 4, 1993

MEMORANDUM FOR THE PRESIDENT

FROM: BILL GALSTON

SUBJ: NATIONAL SERVICE AND STUDENT AID REFORM

I wanted to offer you my views on some issues raised by Secretary Riley's memorandum.

1. I concur with the Secretary's recommendation concerning Decision 1--the proper scope of student loan reform contained in your national service bill.

I believe that it is vital to offer the Congress a solid national service bill that can move forward quickly with a minimum of controversy. Linking national service to overly broad student loan reform risks a congressional firestorm that could slow or even torpedo your principal national service objectives.

While there are many defects in the current student loan system, this bill cannot hope to cure all of them and should not try. Instead, it should deal only with student loan issues, such as income-contingent repayments and direct lending, that are clearly related to your national service initiative while leaving others for further examination and separate legislative proposals.

In particular, I believe that it would be unwise to pursue either Strategy Three or the Pell Grant portion of Strategy Two without extensive study and consultation.

2. I am not yet persuaded that you ought to commit yourself to achieving a system of full direct lending by a specific date.

While many of the arguments against direct lending put forward by the banks, Sallie Mae, and the state guarantee agencies are patently self-serving, some are nonetheless worthy of serious consideration. In particular: while public capital of course carries a lower interest rate than private capital, it is not as clear that the public sector can efficiently manage the many other costs associated with lending. There are many theoretical arguments and speculations about how direct lending would work. But at present, in my judgment, we don't yet have an adequate body of empirical evidence.

The Higher Education Amendments passed by Congress and signed by President Bush last year authorized a significant direct lending demonstration program. You could propose a major increase in the size and scope of that demonstration program and state your intention to use it as the basis of even more comprehensive reform--if it works.

Based on my consultations with banks, state guarantee agencies, and Sallie Mae, I believe that they would readily accept an expanded direct loan demonstration program. They would then have an incentive they now lack to reduce the inefficiencies and excessive profits in the current system--a win-win outcome for students and taxpayers. If after two or three years of a fair test the financial intermediaries can't match the savings from your direct lending demonstration, you could proceed to full direct lending with its opponents in a dramatically weakened position.

If you do choose to commit yourself now to direct lending, I concur with Secretary Riley's recommendation in favor of Option B, which builds on the strengths of the current system, leaves most current actors with at least a limited role, and addresses the fears of smaller, less well-endowed educational institutions (including many historically black colleges and universities) concerning full direct lending.

3. I concur with Secretary Riley's recommendation concerning income-contingent repayment. In particular, it should be an additional option for all borrowers, but it should not be mandatory (except perhaps in cases of actual or potential default under conventional repayment schedules).

As Secretary Riley suggests, IRS participation in collecting and/or servicing students raises a number of complex technical and legal issues. Nonetheless, my preliminary conversations with the IRS Commissioner-designate suggest a genuine desire on her part to achieve maximum feasible IRS cooperation with your national service/student loan program.

THE WHITE HOUSE
WASHINGTON

March 4, 1993

MEMORANDUM FOR THE PRESIDENT

FROM: BILL GALSTON

SUBJ: NATIONAL SERVICE AND STUDENT AID REFORM

I wanted to offer you my views on some issues raised by Secretary Riley's memorandum.

1. I concur with the Secretary's recommendation concerning Decision 1--the proper scope of student loan reform contained in your national service bill.

I believe that it is vital to offer the Congress a solid national service bill that can move forward quickly with a minimum of controversy. Linking national service to overly broad student loan reform risks a congressional firestorm that could slow or even torpedo your principal national service objectives.

While there are many defects in the current student loan system, this bill cannot hope to cure all of them and should not try. Instead, it should deal only with student loan issues, such as income-contingent repayments and direct lending, that are clearly related to your national service initiative while leaving others for further examination and separate legislative proposals.

In particular, I believe that it would be unwise to pursue either Strategy Three or the Pell Grant portion of Strategy Two without extensive study and consultation.

2. I am not yet persuaded that you ought to commit yourself to achieving a system of full direct lending by a specific date.

While many of the arguments against direct lending put forward by the banks, Sallie Mae, and the state guarantee agencies are patently self-serving, some are nonetheless worthy of serious consideration. In particular: while public capital of course carries a lower interest rate than private capital, it is not as clear that the public sector can efficiently manage the many other costs associated with lending. There are many theoretical arguments and speculations about how direct lending would work. But at present, in my judgment, we don't yet have an adequate body of empirical evidence.

Cancel -

I have trig-pending
your response will
be delivered to Podesta.

See attached for
background info.

Roz

O.L. per
a.k. Sullivan
to Wilson
PK

The Higher Education Amendments passed by Congress and signed by President Bush last year authorized a significant direct lending demonstration program. You could propose a major increase in the size and scope of that demonstration program and state your intention to use it as the basis of even more comprehensive reform--if it works.

Based on my consultations with banks, state guarantee agencies, and Sallie Mae, I believe that they would readily accept an expanded direct loan demonstration program. They would then have an incentive they now lack to reduce the inefficiencies and excessive profits in the current system--a win-win outcome for students and taxpayers. If after two or three years of a fair test the financial intermediaries can't match the savings from your direct lending demonstration, you could proceed to full direct lending with its opponents in a dramatically weakened position.

If you do choose to commit yourself now to direct lending, I concur with Secretary Riley's recommendation in favor of Option B, which builds on the strengths of the current system, leaves most current actors with at least a limited role, and addresses the fears of smaller, less well-endowed educational institutions (including many historically black colleges and universities) concerning full direct lending.

3. I concur with Secretary Riley's recommendation concerning income-contingent repayment. In particular, it should be an additional option for all borrowers, but it should not be mandatory (except perhaps in cases of actual or potential default under conventional repayment schedules).

As Secretary Riley suggests, IRS participation in collecting and/or servicing students raises a number of complex technical and legal issues. Nonetheless, my preliminary conversations with the IRS Commissioner-designate suggest a genuine desire on her part to achieve maximum feasible IRS cooperation with your national service/student loan program.



UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF THE SECRETARY

~~CONFIDENTIAL~~

DETERMINED TO BE AN
ADMINISTRATIVE MARKING

INITIALS: JAM DATE: 10/2/17

2017-1069-F

PURPOSE: INFORMATION
FOR MEETING WITH PRESIDENT
DAY: Friday
DATE: March 5, 1993
TIME: 5:00 pm

MEMORANDUM

TO : The President

FROM : Secretary Dick Riley *Dick Riley*

SUBJECT : Options for National Service and Student Aid Reform

This memorandum seeks your guidance on how far to move in the direction of reforming the federal student aid system as part of your efforts to encourage national service and make college more affordable. The mandate for national service offers a window of opportunity to restructure the student aid programs as well.

This memorandum asks for your decisions on three issues related to the national service initiative and student aid reform:

- o How broad should student aid reform be?
- o How can we best provide student loans at a substantially reduced federal cost?
- o How can we best structure student loan repayments, including income contingent repayments, to allow students to take lower paying public service jobs?

We met Wednesday with a group, including White House and OMB staff and several outside experts, to discuss the options presented in the attached paper. Also attached is a list of participants who attended this meeting.

- o All participants thought that federal funds should be the source of capital for student lending since federal funds are less expensive than private funds.
- o Broad consensus existed that a direct loan system should build on the strengths of the existing system to enable us to move immediately to a form of direct lending that can work for all postsecondary institutions, including proprietary schools. Continuing the current system intact but trying to remove excess profits would not be a successful approach.

Page 2 - The President

- o Everyone believed that we should provide borrowers with a range of flexible repayment options, including income contingent repayments, rather than requiring all borrowers to repay through income contingency. Borrowers could then choose the option that best suited them.

I agree with the above discussion. Should you also agree, there are still several outstanding issues.

- o How broad should your student aid reform package be? The group generally agreed that a comprehensive strategy for reform of student aid would be preferable. It would fix the fundamental problems with the current system. This strategy has major political downsides, however, and could detract attention from national service.
- o Who should service and collect student loans? Should different organizations be responsible for servicing and collecting loans under different repayment options? What is the role of the IRS?

The attached paper discusses these issues in more detail. The paper first addresses the overall strategy problem (Decision 1). It then considers key issues regarding the reform of student loans: the development of a direct loan program (Decision 2) and repayment issues including income contingency and IRS collection (Decision 3). I have made recommendations on each of these issues. I look forward to talking with you about them.

Attachments: Paper on National Service and Student Aid Reform
 List of Participants at Secretary Riley's Meeting on National Service and
 Student Aid Reform - March 3, 1993
 Briefing Book (background information on student aid issues)

PAPER ON NATIONAL SERVICE AND STUDENT AID REFORM

DECISION 1: CHOOSING A BROAD STRATEGY

Your campaign focused on two goals related to national service and improved college access.

- o Developing a student loan repayment system that would sharply reduce defaults and would alleviate borrowers' worries about repayment if they took low-paying jobs.
- o Improving the student aid programs, which are costly to the federal government and complicated and confusing for students and their families.

Three strategies are suggested below that, in combination with national service, would achieve these objectives to varying degrees. Each of the three strategies builds on the previous one, with the third being the most comprehensive.

Strategy One: Focus on student loan reforms. This approach would:

- o Reform the student loan programs to reduce federal costs.
- o Provide income-contingent repayment and possibly other repayment options for all student loan borrowers.
- o Reward national service through loan forgiveness.

This strategy could reduce federal costs substantially by reforming the student loan programs, but it would not make the current system appreciably more understandable to students and parents. This strategy could successfully provide a system of loan repayments so that debt would not prevent student borrowers from taking lower paying, public service jobs. Specific options on how to reduce federal costs and improve repayment mechanisms are presented in Decisions 2 and 3.

Strategy Two: Reform other parts of the student aid system as well as loans. The main components of this approach would:

- o Introduce more predictability into the student aid programs by creating an overall federal aid maximum. This approach, recently recommended by a bipartisan commission, would make all students eligible for a particular amount of aid each year--the lesser of school costs or \$10,000, for example. The mix of aid among grants, subsidized loans, and unsubsidized loans would vary depending on the student's family income. This level could push up tuitions at less expensive institutions but might provide a modest form of cost containment for more expensive institutions since aid limits and tuition decisions would be severed.

Broad consensus exists in the higher education community that this approach would be desirable. It would make student aid more predictable, clear and simple.

- o Another matter for consideration is whether we should refocus the Pell Grant program so that it better serves students and brings federal costs under control. The recent reauthorization expanded eligibility so that it will be difficult to fund substantial increases in the maximum grant limits. Changes in the Pell Grant program could be controversial because some students would lose eligibility. I suggest that we conduct a careful analysis of ways to make the Pell Grant program consistent with the plan to provide a predictable amount of aid to all students. We would be happy to conduct this analysis and develop specific recommendations.
- o Streamline and consolidate all student aid programs so that they are easier to understand for students and their families. We have a variety of ideas about how to do this.

Strategy Two would move closer to addressing your goal of reforming and simplifying the entire student aid system. It would make the amount of aid more predictable and the system simpler and more understandable for students and their families.

Strategy Three: Explore better ways to finance postsecondary vocational training, particularly proprietary (profit-making) schools. One possible way to do this might be to:

- o Move the primary responsibility for financing vocational training from Department of Education student aid programs to Department of Labor job training and apprenticeship programs. Moving proprietary training programs to Labor would increase the practice of holding institutions accountable to outcome standards in this field since Labor training programs include some outcome standards, which the student aid programs do not.

Such a strategy would address one of the most vexing aspects of the current student aid system in which aid is used to pay for short-term training at profit-making institutions. Currently, one-quarter of Pell Grant dollars and about one-third of student loan dollars go to individuals attending proprietary trade schools. Borrowers from proprietary schools are four times more likely to default than students from four-year colleges and universities. In addition, institutional abuses of the student aid programs have been prevalent at proprietary institutions.

This matter has not been discussed with Labor and no recommendation has been included here. We could explore this further with Labor and develop recommendations if you wish.

Discussion

Taking a more comprehensive approach, as outlined in strategies two and three, would address many major problems in the current student aid system. The climate for larger changes is quite possible this year given your new administration and the dissatisfaction among some with last year's reauthorization changes. However, some others may resist more comprehensive reform, particularly the third option.

Massive restructuring of the student aid system may detract political attention from national service. On the other hand, these changes could reach all students and create more access to college and public service jobs. The desire to move quickly on national service and its high visibility could help to make comprehensive reform more possible. The more comprehensive your approach to student aid reform, the more you will leave your mark on the system and the more that you will achieve your campaign objectives.

RECOMMENDATION FOR DECISION 1: I recommend that you adopt strategy one and at least part of strategy two to provide a predictable amount of aid to all students. We should also explore ways to refocus the Pell Grant program and ways to better finance short-term job training, especially at proprietary schools. The third option should be explored by the Departments of Education and Labor as we work together to develop strategies for job training.

DECISION 2: REDUCING FEDERAL LOAN COSTS

Reforming student loans should be based on two primary principles:

- o **First, federal funds are the least expensive source of capital for student loans.** Presently, we pay an excessively high rate to lenders for private capital. This difference is the primary source of federal budget savings generated from direct loans. If we eliminate this aspect, much of the potential savings will disappear.
- o **Second, the federal government should not assume direct responsibility for running any specific segments of the student loan system.** Instead, we should opt for a series of public/private partnerships at competitive prices. Each function--such as originating loans, servicing them, and collecting them--should be carried out by the organizations that can best do these activities. This could also provide roles for some of the existing players, but at a much lower price than we currently pay.

Option A: Implement full direct loans. Expanding the direct loan demonstration program now on the books could get us to full direct lending in 1997. This option uses federal capital with schools originating loans. It assumes the elimination of all other players now in the system, such as lenders, Sallie Mae, and guarantee agencies.

- o Full direct lending in this way would simplify the system by eliminating many individual players and would save an estimated \$1.3 billion in FY 1997.
- o Deciding to go to full scale implementation solely through the demonstration program prematurely presumes that this concept does work and that all types of educational institutions will be able to handle the responsibilities entailed in direct lending.
- o There are at least several reasons, however, to believe that some proportion of institutions will not be successful direct lenders because they lack the administrative capability. Others may choose not to participate, especially if no administrative payment is provided to defray the additional costs they incur. To address this issue and the transition from the current system to direct lending requires an alternative mechanism to ensure that all students are still able to borrow.

Option B: Implement direct loans building on the strengths of the current system. Another approach to direct lending is to build on existing programs and institutional actors and allow for different forms of direct lending depending on the capacity of educational institutions. This approach would also use federal funds as the source of capital for student loans.

- o This option would build on existing programs by increasing the size of the direct loan demonstration program; expanding an existing direct loan program, Perkins loans; using other organizations—such as the state agencies, banks, and Sallie Mae—to originate loans for some institutions; and converting current guaranteed loans into direct loans.
- o It would allow us to move more quickly and with fewer risks than the first option. Like the first option, it could save \$1.3 billion in FY 1997. This approach could also include a major role for the states in which they could carry out many functions, including origination, monitoring, servicing, and collections, for the federal government.
- o Increasing the size of the direct loan demonstration program and developing standards to measure the capacity of institutions to handle direct lending will help the Department of Education to structure lending for institutions that don't have adequate resources to handle it directly.

- o Transforming the Perkins Loan program into a direct loan component of the Stafford Loan Program would allow the 3000 institutions that currently participate in the Perkins program to run a full scale direct loan program. Most of the proprietary institutions do not participate in the Perkins program so they would not become direct lenders here. This may be a good idea since they are smaller and tend to have more limited administrative capacities.
- o Designating organizations other than educational institutions to act as loan originators for institutions that are not direct lenders could work well for institutions without the capability to administer direct loans, including proprietary schools. A variety of organizations including banks, state agencies, Sallie Mae, and others could do loan origination for a fee using federal capital.
- o Converting guaranteed loans into direct loans through the government purchase of loans made initially with private capital would allow us to move very quickly and to provide direct loans in the transition period before full implementation of this option.

Option C: Continue the current system intact but remove the excess profits. The current system provides wide access to capital although it does so at a very high price. Using the specter of full direct lending could force lenders to eliminate these excess profits and thereby reduce federal costs. On the other hand, this approach would not address any of the underlying problems in the current student loan programs.

- o Cutting the current return to lenders by 2 percentage points would save almost as much in 1997 as full direct lending. Differences of opinion exist, however, on whether the lenders would participate at this reduced price. Some believe that this payment would be sufficient to assure their continued participation; others believe that banks would stop student lending if its profitability declined. Whatever the specific number of banks which would stop lending, the federal government would need alternatives in place to be sure that access to loan capital did not dry up in certain places or for certain students.

RECOMMENDATION FOR DECISION 2: I recommend the second option because it builds on the existing system and uses several approaches to direct lending. This will enable us to move to a form of direct lending that can work for all postsecondary institutions while saving more than \$1 billion in FY 1997.

DECISION 3: MAKING REPAYMENT EASIER

In designing a repayment system that allows students to repay as a function of their income, two main questions arise: Who should pay through income contingency? Who should collect the loans?

Under income contingency, most, but not all borrowers, would fully repay their loans. Some would not completely repay because their incomes would remain low throughout their lifetimes. The federal government--or taxpayers in general--would repay whatever was not paid. A CBO estimate last year indicated that this would cost the government roughly 5 cents on each dollar loaned, depending on the exact income contingent proposal. This would be about half of current default costs.

Who should repay through income contingent repayments? This system of repayment could be required for all borrowers, or it could be optional for borrowers who choose income contingent repayments.

- o Requiring all borrowers to repay through an income contingent system has the appeal of simplicity because it is applied to all borrowers. On the other hand, it requires that we create a new and costly system for all borrowers, 80 percent of whom have no trouble repaying through current repayment schemes.
- o A second approach would provide borrowers a range of flexible repayment options including fixed repayments, graduated repayments (payments are lower in early years when income tends to be lower and higher in later years when earnings are higher), and income contingent schedules. Borrowers would choose how to repay best their loans depending on their level of debt and income. Defaulters, or those borrowers in danger of defaulting, could be required to repay through income contingency.

Who should collect and service student loans? Full scale income contingency, as discussed above, only makes sense if the IRS does the collection since all borrowers would be repaying on the basis of their income. Under the flexible repayment option, the IRS or some existing student loan organizations such as Sallie Mae or the state guaranty agencies could service and collect loans.

- o The arguments for using the IRS to service and collect student loans based on taxable income are that IRS has the most accurate income information from tax returns and that the IRS has the largest array of enforcement options--sanctions, wage garnishments, etc--available to successfully collect loans.

On the other hand, using the IRS would require major changes to the IRS system, which could take several years and be quite costly. In addition, for the IRS to collect effectively, debt must be legally classified as a tax owed to the federal government, which means that defaulters would be subject to the same laws and penalties used for tax evaders.

How students would pay the IRS is also an issue. If the debt is paid through the W-4 form for withholding, it will be an additional reporting requirement for employers. Business, particularly small business, will likely oppose this and compliance will be more difficult for self employed persons. If, on the other hand, debt is repaid through a lump sum at tax time, it could be a fairly high amount making full compliance problematic.

- o The alternative is for other organizations--such as private firms, Sallie Mae or the state guarantee agencies, for example--to service and collect all student loans, including income contingent repayments. The arguments for using these organizations is that they currently have experience in servicing and collecting, although not income contingent collections. In addition, this approach would not require a new collection system and would not have the negative connotations attached to IRS.

The major drawback is that these organizations would not have as easy access to income information and they would not have the force of the IRS behind them. Getting accurate income information would require either obtaining the information from the IRS or getting it from the borrower. IRS has privacy concerns with giving income information to the Department of Education or its designated collectors, however. Another approach is to require borrowers to provide the information themselves. Reverting to a fixed payment schedule whenever a borrower does not provide the required information would create an incentive for borrowers to provide timely data.

RECOMMENDATION FOR DECISION 3: I recommend the flexible repayment approach rather than requiring income contingent repayments for all borrowers. This allows borrowers the maximum flexibility to choose how to repay.

I also recommend that we continue to explore who should service and collect student loans. We should continue to analyze the feasibility of using IRS to collect student loans with Treasury and other members of your administration.

Attendees
Meeting on Student Aid Reform
Department of Education
March 4, 1993

Secretary Riley

Deputy Secretary Kunin

Maureen McLaughlin, *Acting Assistant Secretary for Postsecondary Education*

Mike Smith, *Consultant and Dean of Stanford School of Education*

Kay Casstevens, *Assistant Secretary Designate for Legislative Affairs*

Billy Webster, *Chief of Staff for Secretary Riley*

Michele Cavataio, *Special Assistant to Deputy Secretary Kunin*

Arthur Hauptman, *Higher Education Consultant and Author*

Tom Butts, *University of Michigan*

Congressman Robert Andrews

Ken Holdsman, *Legislative Director for Congressman Andrews*

Alice Rivlin, OMB

Barry White, OMB

Barbara Selfridge, OMB

Matthew Miller, OMB

Clarence Crawford, GAO

Linda Morra, GAO

Bill Galston, *Domestic Policy Council*

Gene Sperling, *National Economic Council*

Ellen Sideman, *National Economic Council*

Date: 3/23/93Time: 11:30

THE WHITE HOUSE

FAX COVER SHEET

*file
Student
+ Davis
Higher
Ed
Finance*

TO:

Deputy Secretary Runin

Phone:

() 401-1000

FAX:

() 401-3093

FROM:

Ellen Seidman

Phone:

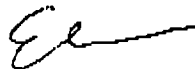
(202) 456-___Pages following cover sheet = 2

THE WHITE HOUSE

WASHINGTON

March 23, 1993

MEMORANDUM FOR DEPUTY SECRETARY KUNIN

FROM: Ellen Seidman 

SUBJECT: Direct Loan Program

To follow up on our brief discussion yesterday after the meeting, I think there are a few things that could be done to help allay some of the skepticism the lending and state guarantee agency group expressed yesterday. It's not clear we will ever get the lenders fully on board, but I think we can reduce the problem they might present.

Further develop some of the parameters of the proposal

By the time the proposal goes to the Hill, we need to be prepared to outline each party's potential role in both the new system and the current system as it phases out. We need to be able to tell people:

- o Who will originate loans, including (i) standards for school and non-school originators (or how these will be set); (ii) who will pay and on what basis (low bid, set fee, fee scale based on some criteria such as loan quality, etc.); and (iii) who will choose an alternate originator if the school is unwilling or unable to originate -- the school, the Department, the state, just to name three possibilities.
- o Who will service loans, including the same parameters regarding choices as with origination. Since servicing is likely to be the most profitable potential activity left for the private sector, they will be particularly interested to know whether an originating school (or non-school originator) will be able to contract for servicing, or whether this will be done solely by the Department. If the latter, you might want to give some thought not only to the type of incentive agreements for good servicing you might want to put in place, but also whether this is an area where calling in some respected potential servicers to help think about the issue might ease some anxiety.
- o Similarly, who will collect, particularly if the IRS is not to collect on all loans, which I think we need to admit is likely to be the case for at least some portion of the transition.
- o Exactly how will we deal with guaranty agencies who wish to pull out of the program and schools whose lenders pull out.

2

The state agencies, in particular, need assurance of their potential role if they are to be our allies in this matter. On the other hand, I understand there is some serious concern in the student loan community whether all state agencies can really be counted on to be quality participants.

Buying in outstanding loans

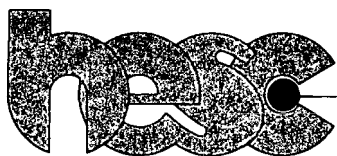
The ABA representative's questions yesterday suggested some real fear on the lenders' part (which I have also heard from Sallie Mae) that the Department plans to force lenders to sell outstanding loans. There are a number of issues to be faced here:

- o Does the Department have a contractual right to require lenders to sell? At what price?
- o If the Department does have such a right, should you assure lenders that it is your intent (i) only to buy in loans that students wish to convert to income-contingent payment status; (ii) only to buy in loans that students wish to convert to income-contingent status and which the lender cannot modify in a manner that satisfies the student ((i) and (ii) are alternatives); and (iii) to pay a fair market price that, because relatively few loans will be bought in, we assume will not be affected by the government's action?
- o If the Department does not have such a right, has thought been given to (i) how to induce lenders to sell when a student wants to switch to income-contingency and (ii) what to do if the lender won't sell for a reasonable price.

The United Negro College Fund

As we discussed, I think it is important to get these folks firmly with us; they should be among our strongest supporters. You might have your outreach person talk to the UNCF representative who was at the meeting yesterday, but I think a call from either you or Secretary Reilly to Bill Gray would probably be useful. Gray is no one's fool, and will not support something he feels will injure his schools or their students, but (i) if he thinks the program will be harmful, it would be well to know that in advance, as well as why, and what it would take to fix it; and (ii) he's both a sensible person and a politician (I don't mean to suggest they're usually incompatible!) and understands that insisting on getting his entire agenda at once may not be the best course of action. If he does not think this program is inherently harmful (and hopefully thinks it would be good), he may be willing to support it strongly if he thinks help is on the way for the larger issues facing his schools and students.

I hope this is helpful.



NEW YORK STATE

HIGHER EDUCATION SERVICES CORPORATION

Cornelius J. Foley
President

March 22, 1993

Mr. William Galston
Domestic Policy Office
The White House
West Wing
Washington, D.C. 20500

Dear Mr. Galston:

I am pleased to share with you a copy of a discussion paper our Agency developed for consideration by the Advisory Committee for Student Financial Assistance as part of the committee's study of federal student loan program simplification and alternatives.

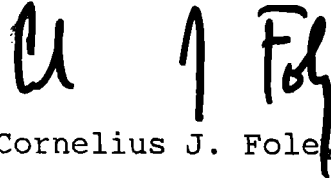
The paper, entitled "The Federal Student Loan Delivery System: Options for the Future," contains a set of proposals which could save the federal government \$2.15 billion in the first year of implementation and over \$12 billion in the first five years. Moreover, these savings are based upon actual working program adjustments, not budget gimmickry, and they would not in any way increase federal debt. The savings from these program reforms would meet--indeed exceed--the budget savings assumed by the President in the student aid portion of his economic plan. And, the savings begin in the first year (\$2.15 billion), in contrast to the direct loan proposal which according to the Congressional Budget Office would cost over \$378 million in the first 2 years. For these reasons, we believe that our proposals should be considered by the Administration and the Congress within the current debate on Direct Loans.

We have developed the paper from our perspective as New York State's postsecondary student financial aid administrative agency. Each year we provide 500,000 students with over \$1.6 billion in federal and state-sponsored grants, scholarships and loans. We are the second oldest and fourth largest student loan guarantor in the nation. We have one of the industry's lowest student insurance premiums and default rates, and one of the highest collections recovery rates in the program.



We plan to update the paper over the next few weeks and welcome your comments and suggestions. Please contact Peter Keitel, Executive Vice President, (518) 474-5775, or Charles Treadwell, Director of Research and Policy Analysis, (518) 474-1549, for more details.

Sincerely,

A handwritten signature in black ink, appearing to read 'C J Foley', written over the printed name.

Cornelius J. Foley

Enclosure

THE WHITE HOUSE

WASHINGTON

March 17, 1993

MEMORANDUM FOR BO CUTTER
GENE SPERLING

FROM:

Ellen Seidman *ES*

SUBJECT:

Visit from Larry Hough and Tim Greene of Sallie Mae

*File
Sallie
Mae
Higher
90d
Mk.*

On March 15, Larry Hough, President and CEO of Sallie Mae, and Tim Greene, General Counsel, visited me to discuss the direct student loan program and Sallie Mae's conversion to a completely private corporation.

On the subject of direct student lending, Hough was adamant that the savings in the Administration's plan, and more particularly the \$6-7 billion savings that he says CBO has calculated for the budget resolutions, will not be realized because:

- o The Education Department, he asserts, is simply incapable of running the direct loan program, including contracting out for services, particularly at the same time it is running the remnants of the guarantee program.
- o There will be insufficient capacity in the industry both to originate and service the loans, as commercial banks will pull out (since they see no future in the program) before new originators (including colleges) and servicers are on line. This will both increase the price the Education Department must pay for origination and servicing and reduce its quality. Hough says that approximately 20% of the loans are serviced by holders rather than any secondary market agency, and that originating Perkins loans is far easier for colleges than originating the kind of loans involved here, so that Perkins capacity cannot be assumed to be totally available for the new program.
- o Hough asserts that some of the administrative cost savings are budget gimmicks, as these are real expenses that appear nowhere in the budget for a direct loan program, i.e., they are counted neither in the subsidy nor in any S&E account.
- o CBO assumes funding the program with 10-year Treasuries, rather than with maturity-matched funding. While this may accurately reflect what the government will in fact do, it means that savings are exaggerated because of the substantial drops that have occurred in medium term interest rates.

Hough also maintained that if income contingent repayment is a major goal of the change, it can be accomplished more quickly under the current program. He said that Sallie Mae's upcoming conversion of its loans from coupon-based repayment to billing means that for Sallie Mae, at least, this change would be relatively easy to administer (although it does require the IRS to verify a borrower's statement of income).

I listened to Hough's arguments, and pointed out that the President's February 17 program encompassed direct lending.

On the subject of Sallie Mae's conversion to a private entity, Hough urged quick action, saying the cloud over the stock was causing serious problems. He pointed out that many pension funds and other institutional investors who the Administration would like to invest in other government-related enterprises (like infrastructure) are big Sallie Mae stockholders. He emphasized the following points:

- o Sallie Mae wants a total break with the government, encompassing loss of all GSE privileges, including the securities laws exemptions and access to FedWire.
- o They envision creation of two classes of debt, with debt issued before the start of privatization retaining its current status and privileges, but new debt totally unguaranteed and without any of the collateral GSE privileges. The assumption is that the GSE-status debt, being relatively short-term, will roll off quickly, after which the company would be totally private.
- o At the start of the privatization process, Sallie Mae would want relief from current charter restrictions, but the new operations (and indeed, the continuation of old operations to the extent new debt was required to fund them) would be financed only with non-GSE funds. (The assumption here is that the company's equity is, and always has been, non-guaranteed.) Hough and Greene admit this will take some structuring, but say they have given it a good deal of thought over the last several years.
- o Hough believes that even without GSE status Sallie Mae could borrow at close to its current rates, and in any event at a level that made it profitable to buy in much of the outstanding guaranteed debt as the direct loan program kicks in, which he said would be a major part of the corporation's strategy.

I explained to Hough that the Treasury Department would be pursuing this issue in the first instance. Hough has since called Debbie Danker to start the process going.

cc: Bill Galston

Deputy Secretary Kunin, Department of Education

Maureen McLaughlin, Department of Education

Frank Newman, Treasury

Debbie Danker, Treasury

FF/

New Q & A materials
prepared for the debate
on the budget resolution.

The National Debt

Claim: The switch to direct lending will increase the national debt.

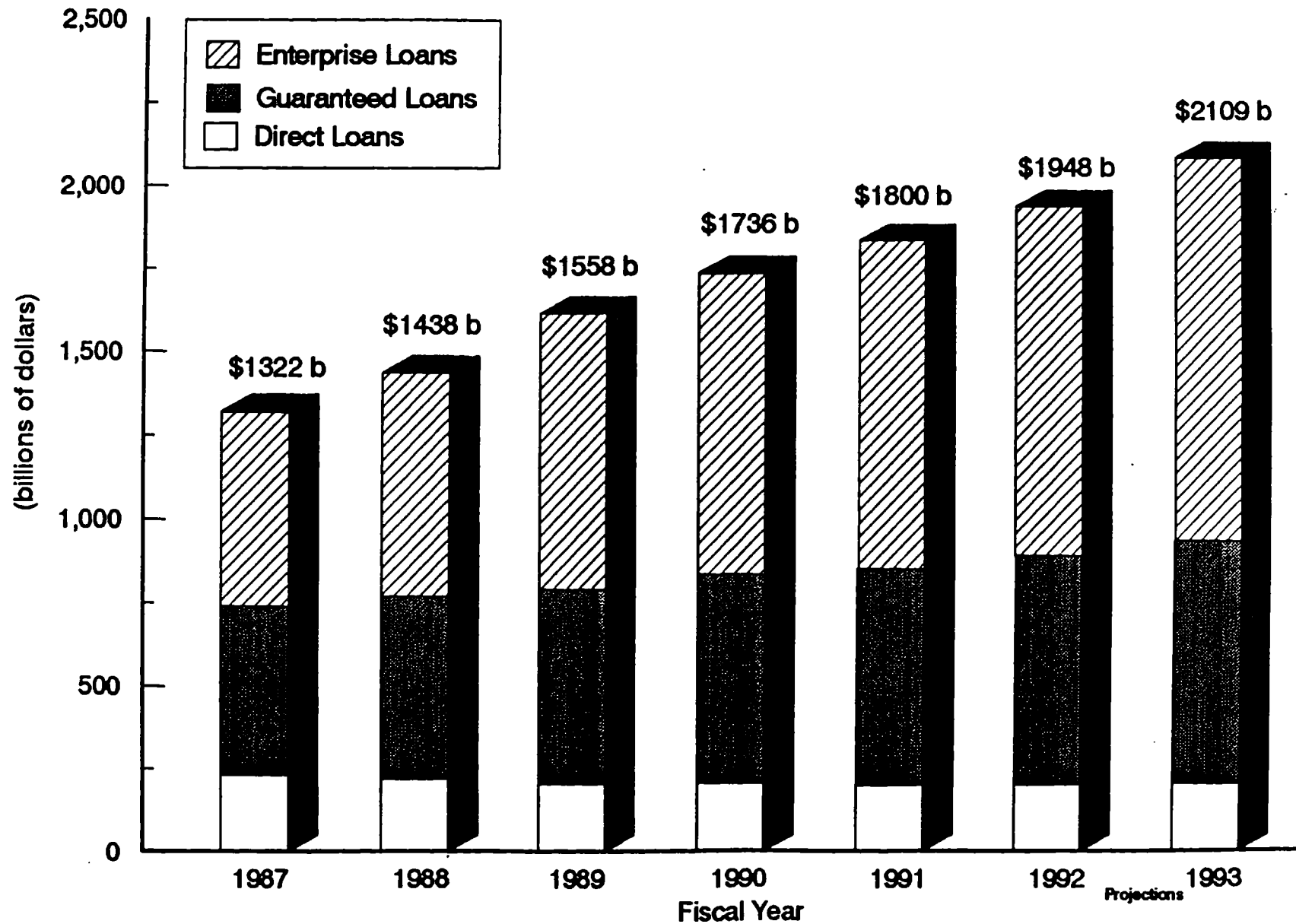
Responses:

- There is *no* net effect on the government's debts. Direct loans and guaranteed loans are both included in the Federal budget as liabilities. Switching from one to the other has no effect on the economy or on the financial health of the Federal government. (See chart from the Treasury Department identifying them both as "Federal Government Loans." The total debts don't change, only the distribution.)
- The switch to direct lending will temporarily increase one type of Federal borrowing, but it will be offset by another type of debt. Both direct loans and guaranteed loans are counted as "contingent liabilities" in the Federal budget. What really matters is the amount that taxpayers have to chip in each year to pay off the national debt. That amount is at least \$1 billion *higher* under the current system than it would be under direct lending.
- Switching from guaranteed to direct student loans actually *reduces* the *deficit*, because it saves money.
- To assume that guaranteed loans are necessarily better than direct loans because of Federal borrowing is like saying it is always better to rent a home than to buy one because renters avoid debt. This ignores the fact that there is an asset balancing the debt. Like home ownership,

with direct lending the Federal government owns the student's loan; it is an asset that brings in income.

- The Federal government is already a cosigner on guaranteed student loans. Shifting to direct lending does not put the Federal government at any greater risk. We still pay if there is a default, but overall our costs are lower.

FEDERAL GOVERNMENT LOANS OUTSTANDING FY 1987 -1993



Education Department's Administrative Capabilities

Claim: The Education Department has a poor track record in managing programs, and direct lending would place "enormous additional administrative responsibilities" on the Department.

Response: Direct lending is a much simpler system than the guaranteed loan program, and the Administration has included in the budget a significant upgrading of the Department's administrative capacity.

- GAO's report on high-risk programs calls the current student loan system "a complicated and cumbersome process" (see chart). In the current program, the Education Department not only has to keep track of loans to students, but payments to 8000 lenders, in various combinations through 46 guaranty agencies. *It is impossible to track the money in the guaranteed student loan system.* This is the result of complexity, not incompetence. (Refer to the dotted lines in the GAO chart, representing the money flow).
- The current system has far more administrative problems than a direct lending system could ever have. Still, to make sure that the new system is sound, OMB has allowed for hundreds of millions of dollars of administrative costs at the Department, which have been subtracted from the direct lending savings. The administrative costs estimated by CBO are even higher, and again they are included in the cost estimate. Even after accounting for these costs, direct lending saves money.

- I urge anyone defending the current system to read the financial audit of the GSL program, completed just last week by GAO. It concludes that the structure of the guaranty system “is not conducive to good financial management.” The report identifies “serious problems in the program’s structure,” particularly with respect to guaranty agencies:

--”Guaranty agencies assume little financial risk and are not compensated in a way that provides sufficient incentives to prevent defaults.”

--”[M]any guaranty agencies have expanded their operations to activities that create serious conflicts of interest with their stewardship responsibilities.”

--”By assuming servicing and ownership roles, guaranty agencies are, in effect, responsible for regulating their own activities.”

(For other findings of the GAO audit, see the “fraud and abuse” sheet).

- Direct lending systems would be much simpler than the current system (see second and third charts).
- The analysis of direct lending conducted during the Bush Administration determined that direct loans would be simpler:

--”A Direct Loan program would be easier to manage and would greatly reduce opportunities for error and abuse. A centralized data base would improve data integrity and auditability. Department monitoring

could be focused entirely on the postsecondary institutions and the collection contractors.”

--A direct loan system “would be built upon a base of Education Department expertise in two key areas: (1) allocating funds to schools (as in the Pell Grants and Campus-based student aid programs), and (2) contracting directly for student loan collections. ED has performed these functions well for many years.”

Figure 1: Federal Family Education Loan Program: A Complicated and Cumbersome Process

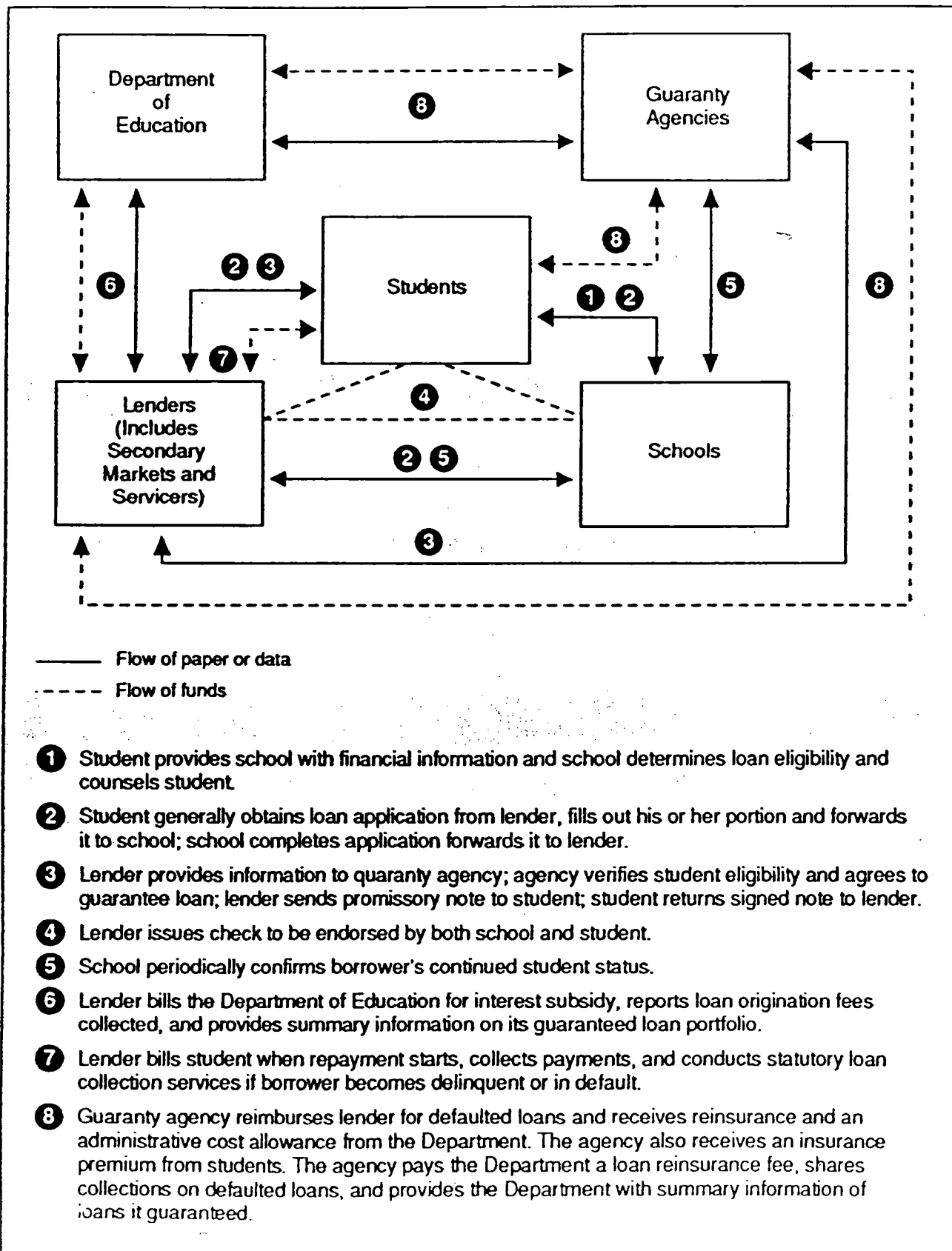
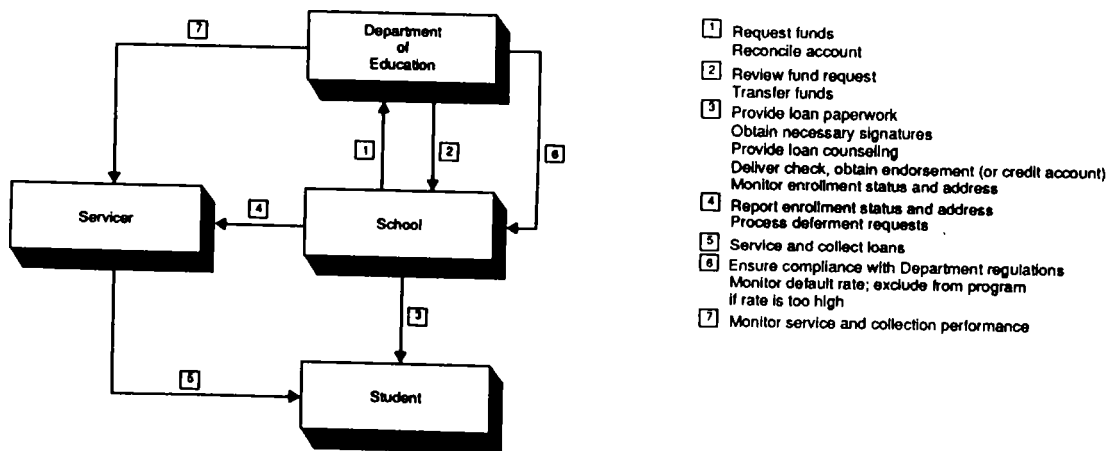
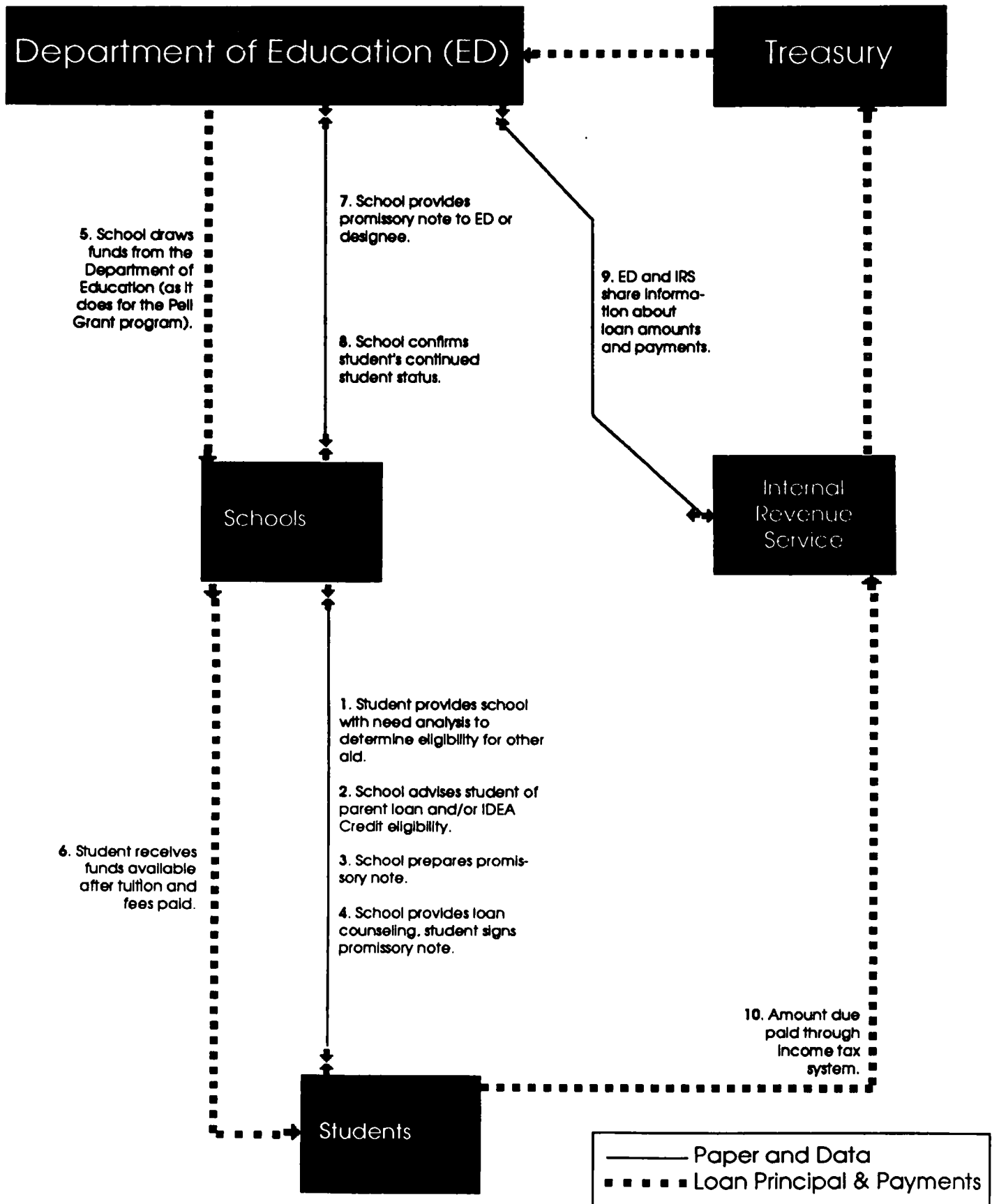


Figure I.18

GAO Flow of Responsibilities: Direct Loan



IDEA Credit



The Burden on Schools

Claim: Direct lending would shift administrative costs to schools.

Response: If this were true, the higher education associations would oppose direct lending. They do not. In fact, they support it.

- A statement issued March 2, 1993, by 12 higher education groups states that "The Clinton Administration's FY 94 budget proposal assumes full conversion to a direct lending program and a phase-out of bank-based lending by July 1997. The higher education associations listed below support this transition. . ." The list includes not only large colleges; it includes community colleges, Catholic colleges, Jesuit colleges, and other independent institutions.
- The 2100-member National Association of College and University Business Officers--hardly a group that would support anything that would increase their costs--testified that: "Direct lending would bring (in most cases) all components of a student's financial aid package to the campus, expedite the flow of funds to eligible students, and simplify and improve the receipt and disbursement of funds functions. *We firmly believe that institutional administrative efficiencies and improved controls can be achieved under a direct loan program when compared with the overall current guaranteed student loan process which in turn would also better serve the student borrower.*"

- GAO concluded (September 1991) that direct lending would “simplify paperwork for schools.”
- Some schools’ past opposition to direct lending was based on misunderstandings about how the programs would work. For example, the perception that the black colleges cannot or do not want to participate in a direct lending system is based on testimony by one college president who said he did not want to be responsible for “collecting those debts.” Direct lending does not place collection responsibilities with the colleges.
- To be certain that schools not comfortable with direct lending are not forced to participate, the Education Department plans to establish alternative loan origination processes for those schools that want them.

March 1, 1993

1993 MAR -3 PM 3:03

The Honorable Paul Simon
United States Senate
462 Dirksen Senate Office Building
Washington, D.C. 20510-1302

Dear Senator Simon:

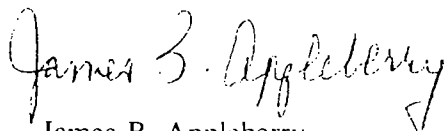
We are writing to you on behalf of the more than 500 member institutions of AASCU and NASULGC to urge your review and consideration of the recently released report of the bipartisan National Commission on Responsibilities for Financing Postsecondary Education. The report, entitled *Making College Affordable Again*, makes a number of important proposals regarding an overhaul of the federal government's role in the financing of higher education that we believe would vastly improve access and affordability for all Americans.

We are especially pleased that one of the most important aspects of the Commission's recommendations, a switch from the expensive Guaranteed Student Loan Program to a new direct federal lending program, has been adopted by President Clinton as part of his proposed higher education agenda. Numerous analyses and studies of direct lending, most recently by the Government Accounting Office, indicate that federal savings of upwards of \$1 billion could be realized through a switch from the GSL program to direct lending.

Over the years the GSL program has developed its own small constituency of beneficiaries who have already organized to fight for a continuation of the program and the enormous taxpayer subsidies that go along with it. An early event in the campaign to discredit direct lending takes place today and tomorrow. This activity will consist of briefings and Hill office visits against the President's direct lending plans.

AASCU and NASULGC have studied the potential benefits and the possible costs of direct lending for more than a year. Our analysis indicates direct federal lending to be a viable and vastly superior system of federal assistance to your constituents. We urge you to review the Commission's report, GAO studies of direct lending, and the President's budget proposal, and to choose the financing option that is in the best interest of America's students and taxpayers rather than the profits of narrow interest groups. Of course, we will be available to work with you and your staff.

Sincerely,


James B. Appleberry
AASCU


C. Peter Magrath
NASULGC

American
Association
of
State
Colleges
and
Universities

One Dupont Circle
Suite 700
Washington, DC
20036-1192
202/293-7070
fax 202/296-5819



National
Association
of
State
Universities
and
Land-Grant
Colleges

One Dupont Circle
Suite 710
Washington, DC
20036-1191
202/778-0818
fax 202/296-6456

THE WEEK IN REVIEW

National Association of Independent Colleges and Universities



Dear Friends:

This is an extremely important time for higher education at the national level. President Clinton is fully committed to moving forward on a national community service initiative, accompanied by an income-contingent loan repayment option, both of which are high priorities for NAICU. The president is equally committed to reforming the loan program to meet his goals of reducing taxpayer expense while providing income-contingent and community service repayment options. Whether that means direct lending, or some other reshaping of the loan programs, is under active discussion.

The president's budget requires significant savings from reforming the loan program, and Congress will support those budget reductions. The White House, the Office of Management and Budget, and the Department of Education continue to discuss the shape of these programs. We are talking with all of these parties, and providing them with ideas about what options are most important for our institutions and the students who attend them. We believe that the administration will release a loan reform proposal sometime this spring. At that time, we may come to all of you for help.

A lot of misinformation is being generated about how a restructured loan program might work. The problem is that there is no one single model for direct lending - some configurations work better than others. But the lack of detail is being used by some to actively campaign against loan restructuring and reform. While some of the nay-sayers have legitimate concerns that must be taken into account, we simply cannot let them prevent us from finding ways to make the loan program work better and at less cost, while providing more repayment options for students. Meanwhile, please send us copies of letters you receive that raise questions about the proposed new loan program.

NAICU is forming a special advisory task force to work through details of the essential elements we must have to make loan reform work. The NAICU Commission on Financing Higher Education will discuss this at its April meeting, and will try to develop some basic policy parameters to guide us in the next several months of negotiation.

We have also included in this *Week in Review* an insert on alternative loan programs. Please share this information with the appropriate people on your campus. As discussions continue, it is important that students and families receive assurances that financing for higher education will be maintained.

Sincerely,

Richard F. Rosser
President

Why not direct home loans?

Claim: Is direct student loans the first step of a Federal takeover of nearly all lending?

Response: No. Student loans are unique because there is no evaluation of the borrower--anyone can get a student loan. Also, with student loans, the government already takes all of the risk, and the schools already do most of the work.

- With all other loans, the lenders perform a very important service: they evaluate the borrowers, and they evaluate the reason for the loan, such as the value of a home, car, or other property. The bank takes the risk of being wrong, and gets the benefit of being right. With student loans, however, it is the Federal government's policy that everyone should have access to college, so loans are available to anyone at eligible schools, and the Federal government takes all the risk.
- In the guaranteed student loan program, students rarely ever go into a bank. Colleges provide the loan application, confirm students' eligibility for the program, and counsel borrowers about their repayment responsibilities.
- Most banks do not collect student loan payments. Instead, while the student is in school, the bank bills the Education Department for interest payments quarterly. Then, when the student leaves school and the collection work begins, the bank sells the loan to a wholesale lender. Often, the wholesale lender contracts with a private servicer.

IRS Collection

Claim: The details of IRS collection of student loans are not yet clear.

Response: While I support IRS collection as the most efficient and effective method, it is not a foregone conclusion in the budget resolution. Both the CBO and OMB estimates assume that the government would pay private sector servicers to collect payments. If Congress and the Administration decide to use the IRS, the savings would be even higher due to reduced defaults and lower servicing costs.

- The IRS already collects defaulted government loans by offsetting tax refunds. More than \$2 billion was collected this way last year.
- Last year, IRS representatives testified that, while they are not eager to expand their role in collecting student loans, they could do it. And I am pleased that the designee for IRS Commissioner, Peggy Richardson, is committed to working out the details of IRS collection. She says it clearly can work.
- Australia has an income-contingent student loan system, collected by their equivalent of the IRS. It works well, without an additional burden on employers. This same type of system can be adapted for the United States. There would be no need for a new line on the W-2. Instead, an employee would simply ask for additional withholding, something they can already do.

The Transition: Access to Loans

Claim: As lenders see the end of the GSL program on the horizon, they will stop participating, and students will not be able to get loans.

Response: This is highly unlikely. Student loans are very profitable, more profitable than home and car loans according to an Education Department report. If some lenders back out, others will step in and increase their volume of loans. The Federal guarantee remains on all outstanding loans. Moreover, the Education Department is putting together a plan to ensure continued access to loans for all eligible students during the transition.

The Transition: Guaranty Agency Failure

Claim: The savings from direct lending don't include the costs that the Federal government will have to pay to bail out the guaranty agencies.

Response: This is not true. The OMB and CBO estimates *do include* these transition costs, even though the budget rules would appropriately charge these costs to the loans made in previous years. Even after these costs have been considered, direct lending still saves money.

The Federal costs of taking over insolvent guaranty agencies is a cost of the GSL program, not of direct lending. In a letter to the chairman of the House Education and Labor Committee (February 8, 1993), GAO explained: "A lesson learned from the savings and loan disaster is that hidden insolvencies do not go away. Rather, the problems tend to worsen. In this case any insolvencies would be attributable to inadequate financial reserves, high loan default levels, and insufficient loan default recovery. . . The dependence of some guaranty agencies on the cash flow associated with making new loan guarantees to cover unfunded costs represents a shell game for the federal government. A direct loan program would merely unmask the guaranteed student loan program's hidden costs."

The Transition: Will old loans get collected?

Claim: When the direct loan program begins, lenders and secondary markets will no longer try to collect the billions of dollars of outstanding guaranteed loans.

Response: Lenders will not stop collecting the outstanding loans. If they did stop collecting, the loans would lose the Federal guarantee, and the bank would lose the money. The incentives for lenders and secondary markets to collect payments on loans would not change.

Fraud and Abuse

Claim: Under direct lending, problem schools will have open access to Federal money.

Response: These schools already have access to Federal funds through any of 8000 different lenders--lenders that have little financial stake in ensuring that the funds are spent wisely. Ensuring that there is only one spigot through which the Federal funds would flow gives the Federal government more control, and more tools for sensing and stopping fraud and abuse.

- Congress and the Education Department have already taken many steps to eliminate schools that do not provide a good education. This process must continue whether we shift to direct lending or not.
- Because schools deal with many different lenders and guaranty agencies, it can take two years or more before the Education Department has complete data on the amount of loans at a school. This has allowed fraud by schools--and by banks--to go undetected for months or years. With direct lending, the Education Department would know about a questionable increase in borrowing at a school *before* that borrowing took place. The Department could seek further information, and, if necessary, turn off the spigot.
- The complexity of the current system makes it very difficult to track loans and Federal subsidy payments. The GAO financial audit of the GSL program (March 1993) concluded that the "Program's structure is not conducive to good financial management." Among the findings:

--"None of the 10 guaranty agencies we visited reconciled quarterly and yearly data and only one reconciled its monthly bills to its quarterly reports submitted to the Department."

--"We compared the information on tape dumps submitted to Education with guaranty agency source documents for 30 randomly selected loans and found that 19 had errors in the reported status of loans and student enrollment."

--"Lender billings to Education often include loans guaranteed by several different guaranty agencies. However, the guaranty agencies we visited limited their reviews [of lenders] to the loans they guaranteed. . .[T]hey could not project an estimate of the accuracy of a lender billing [to the Department] and thus could not provide the Department with assurance that these billings were accurate."

--Discrepancies in data "could result in Education not receiving millions of dollars of loan origination fees owed by lenders."

This complexity and cost is unnecessary and counter-productive.

The CRS Report

Claim: The Congressional Research Service concluded that direct lending would not save money.

Response: CRS did *not* reach that conclusion. The report does confirm, however, that the student loan industry is taking excess profits while the government assumes virtually all of the risks in the student loan program.

- While the report suggests that there may be other ways to save money in the GSL program, it gave little practical direction. The direction it does provide would cause many students to lose access to loans.
- The CRS report is a theoretical economic discussion, not a cost estimate. All of the government cost estimates-- by GAO, CBO, and OMB--find that the switch to direct lending would save a billion dollars or more per year.
- The conclusions in the CRS report that at first sound significant turn out to be rather uninteresting; they are knocking down straw men:

--The CRS report says that under direct lending, "Any increased funding available for public spending would be exactly offset by reduced private sector income." This means that multi-million dollar salaries at Sallie Mae can instead be used to reduce the deficit, and that's precisely the point. Taxpayers, who already shoulder all of the risk in the GSL program, are paying for complexity, inefficiency, and excess profit. Direct lending simplifies the system and lets the benefits

accrue to the taxpayers.

--The CRS report says that "National income would not be increased" with direct lending. It then goes on to explain: "no loanable funds would be freed to increase output and wealth." The use of the term "national income" is deceiving, because the CRS economists don't mean "the Federal budget," they mean "the whole U.S. economy." So, in other words, they mean that the nation's overall supply of capital is fixed, and the President's plan would shift loan capital from Federal guaranteed loans to Federal direct loans. Again, that's precisely the plan.

- CRS suggests that the Federal government could reduce the excess profits and save money by lowering the interest subsidy in the GSL program. But there is no way for us to know what that "optimal" rate is. And as we experiment to figure it out, many schools and students--particularly those at community and state colleges who are less profitable to banks--will not be able to get loans.
- CRS also declares that "real economic gains could be made by targeting the [GSL] program differently." This means not loaning money to students who are going to be failures in college. ("Failure" is defined as those for whom college does not significantly increase their income). Of course, this would be an unpopular if not impossible policy to implement. Everyone should have the opportunity for a college education.



THE UNIVERSITY OF MICHIGAN

Washington Office
499 South Capitol Street, S.W., Suite 501
Washington, D.C. 20003
(202) 554-0578 (Office)
(202) 554-0582 (Fax)

Date: 3-1-93

No. of Pages to Follow: 1

To: Bill Galston

From: Tom Butts

Regarding: Bob Shireman

asked me to forward
this to you.

March 1, 1993

The Honorable William D. Ford
U.S. House of Representatives
2107 Rayburn House Office Building
Washington, D.C. 20515-2213

Dear Congressman Ford:

We are writing to you on behalf of the more than 500 member institutions of AASCU and NASULGC to urge your review and consideration of the recently released report of the bipartisan National Commission on Responsibilities for Financing Postsecondary Education. The report, entitled *Making College Affordable Again*, makes a number of important proposals regarding an overhaul of the federal government's role in the financing of higher education that we believe would vastly improve access and affordability for all Americans.

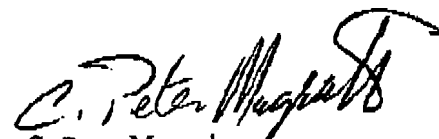
We are especially pleased that one of the most important aspects of the Commission's recommendations, a switch from the expensive Guaranteed Student Loan Program to a new direct federal lending program, has been adopted by President Clinton as part of his proposed higher education agenda. Numerous analyses and studies of direct lending, most recently by the Government Accounting Office, indicate that federal savings of upwards of \$1 billion could be realized through a switch from the GSL program to direct lending.

Over the years the GSL program has developed its own small constituency of beneficiaries who have already organized to fight for a continuation of the program and the enormous taxpayer subsidies that go along with it. An early event in the campaign to discredit direct lending takes place today and tomorrow. This activity will consist of briefings and Hill office visits against the President's direct lending plans.

AASCU and NASULGC have studied the potential benefits and the possible costs of direct lending for more than a year. Our analysis indicates direct federal lending to be a viable and vastly superior system of federal assistance to your constituents. We urge you to review the Commission's report, GAO studies of direct lending, and the President's budget proposal, and to choose the financing option that is in the best interest of America's students and taxpayers rather than the profits of narrow interest groups. Of course, we will be available to work with you and your staff.

Sincerely,


James B. Appleberry
AASCU


C. Peter Magrath
NASULGC

THIS LETTER HAS BEEN SENT TO ALL CONGRESSMEN

American
Association
of
State
Colleges
and
Universities

One Dupont Circle
Suite 700
Washington, DC
20036-1192
202/295-7870
fax 202/294-5819

National
Association
of
State
Universities
and
Land-Grant
Colleges

One Dupont Circle
Suite 700
Washington, DC
20036-1191
202/778-6015
fax 202/778-6116