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Statement of Robert Shireman

Joint Informational Hearing of the Assembly Committee on Banking & Finance and the Assembly Higher Education Committee, California State Legislature

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Thank you for the opportunity to testify today. I am Robert Shireman, the president of the Institute for College Access & Success, a national, nonprofit research and policy organization based in Berkeley. I have nearly 20 years of experience working on higher education policy issues, first as an aide to former U.S. Senator Paul Simon of Illinois, and then in the Clinton White House at the Office of Management and Budget and the National Economic Council (where, among other things, I monitored the creation of a performance-based organization to manage financial aid programs at the federal level). For the past few years I have led the Institute's successful efforts to improve repayment plans on federal student loans.

In less than a generation, we have gone from a nation where fewer than half of our college graduates had student loans, to two-thirds graduating with loan debt. This is a result of rising college costs, grant aid that has not kept pace, wider availability of loans, and stagnant wages both for families and for students who work. A college degree has become the ticket to the middle class, and loans are now critical to earning that degree. For the sake of our economy and our communities, public policies must ensure that student loans are available and affordable. Californians need to be able to count on federal loans so that they do not scuttle their college plans or hurt their chances of completing a degree by working when they need to be studying.

Nationally and in California, the data that are available about student debt are not as complete or as reliable as we would like. But based on the data that are available, it appears that the average levels of student debt in California are somewhat lower than the national average, except at for-profit colleges. This is a testament to the state's efforts to limit fees, the Cal Grant program, and institutional aid provided by public and private nonprofit four-year institutions.[1]

Student Loan Debt of Bachelor's Degree Recipients (2003-4)

	Percent with Debt		Average Amount	
	California	National	California	National
Public 4-year	54%	62%	$15,095	$17,249
Private Non-profit	63%	74%	$21,858	$22,125
For-profit 4-year	n/a	88%	n/a	$27,647

Student Loans to Full-Time Freshmen (2005-6)

	Percent Receiving		Average Amount	
	California	National	California	National
Public 4-year	30%	44%	$3,486	$4,163
Private Non-profit	53%	58%	$5,006	$5,220
Public 2-year	3%	18%	$3,199	$2,821
For-profit 2-year	63%	63%	$5,775	$5,320
For-profit 4-year	66%	64%	$8,317	$7,039

To give you a sense of how student loans fit into financial aid packages, I have attached to my testimony some examples of the way that a middle-income family ($80,000, about the median for a family of four in California) and a lower-income family ($40,000) might be expected to cover college expenses at different types of institutions in California.

Access to Federal Loans

Ninety to 95 percent of the student borrowing in California is in the form of "federal" loans: loans that are either made directly from federal funds, or loans that are backed by the federal government but issued by a bank or other lender. The Direct Loan Program provides loans directly from the U.S. Treasury. The guarantee approach is known as the Federal Family Education Loan (FFEL) Program.[2] In both programs the government carry the risks normally borne by lenders.

The FFEL and Direct Loan Programs both offer the same two loan types: Stafford loans for undergraduate and graduate students, which are available without any credit check; and PLUS loans for parents and graduate students,

[1] The data in the table are enrollment-weighted within each sector, based on the institutions reporting. The individual colleges' student debt figures come from Peterson's Undergraduate Financial Aid Database; we have particular concerns about these data because many institutions fail to report or fail to update their figures. Data on loans to first-time full-time freshmen come from IPEDS (Integrated Postsecondary Education Data System, managed by the National Center for Education Statistics, U.S. Department of Education).

[2] A small third federal program, Perkins loans, does not play a major role at most schools and is not designed in a way that would allow it to expand dramatically.

which are limited to those who have no significant credit problems. The FFEL and Direct Loan Programs use identical criteria to determine who can borrow and how much they can get. Schools decide whether to use one or both of the loan programs to deliver essentially the same products. [3]

I'm going to briefly describe the way each program works, because which loan program a school has chosen affects whether or not they have any reason to be concerned about loan access for their students.

Colleges in the Direct Loan Program (about 23 percent of the loan volume in California) have experienced no changes or disruptions in federal loan availability during the credit crunch of the past several months. These schools determine the amount of Pell grants and federal loans their students are eligible for and the amounts the students plan to take, then the schools electronically draw down the money from the U.S. Treasury and the students and parents receive their funds soon after. Financial aid administrators at Direct Loan schools have told us that their need for emergency loan programs has virtually disappeared because they are in total control of when federal grant and loan funds arrive.

There is no limit on the number of schools that can be in the Direct Loan Program, and there is no cap on the total funds available for loans. It is an entitlement program—whatever the demand from eligible students and schools, even if it is different from budget projections, the federal government provides the funds. The only circumstance that could cause Direct Loan funds to be unavailable would be if the federal government literally ran out of money and could not find buyers for Treasury bills. If that were to happen, then the FFEL program would also be shut down, and we as a nation would have *much* bigger problems than a lack of student loans.

The FFEL program operates differently. Lenders have an entitlement to certain subsidies from the government: a guaranteed interest rate return based on market rates, and reimbursement of defaults. They get the subsidies *if* they make the loan. But they can choose which schools or students they want to emphasize or restrict, and they can change those plans at any time. In recent years, schools got accustomed to being courted by a bevy of eager lenders. In a profitable game of arbitrage, these companies were able to use federally-backed loans – with their guaranteed returns -- as collateral for a virtually unlimited supply of low-cost financing in a highly liquid world credit market. In that environment, lenders were happy to make federal student loans pretty much anywhere there were eligible students.

Then the credit party ended, first in sub-prime mortgages, and then beyond. Some non-bank student loan companies shut down completely after their only source of money disappeared. Banks saw that they could not necessarily rely on credit markets to supply an unlimited amount of low-cost funds for loans. Some of them decided to focus their marketing on the most profitable loans that they can make. In federal student loans, the best returns

[3] Loan terms, such as fees, can in some cases be slightly different. See the attached chart for details.

come from the elite colleges and especially their graduate and professional schools.

Here's why those bigger student loans are the most desirable from a FFEL lender's perspective. Let's say a student at Sacramento City College has $5,000 in Stafford loans, while a graduate of the University of the Pacific (UOP) has $20,000. The amount of work the lender needs to do is the same for each borrower: one promissory note, one monthly bill, one phone call if the borrower's payment is late. But the interest income on the UOP loan is *four times* the interest income on the community college loan. That's why a lender might abandon a community college while showering attention on students (and on financial aid officers) at medical schools, law schools, and selective four-year colleges. It's not that the small loan is necessarily unprofitable; it's just that it is not as profitable as the large loan.

Schools in the FFEL program are now facing the reality that lenders can come and go if they want to (or need to). It's a reality of the business world that cannot easily be legislated away.

The role of guaranty agencies. Because bank loans in FFEL are uncertain, the U.S. Secretary of Education assigns each state to a guaranty agency (some agencies are assigned to multiple states); the designated agency is responsible for ensuring loan access in the event that FFEL loans are not available to students in certain communities or at particular schools. CSAC, through its EdFund affiliate, is California's designated guarantor.[4]

While these agencies are *responsible* for loan access in their designated state(s), they are *allowed* to guarantee loans from any state, and their federal subsidies come from taking on the federal administrative duties associated with those loans.[5] Over the past few months, why weren't guaranty agencies falling over each other to offer support and assistance to community colleges worried about loan access? After all, if they can get the guarantee they get the income, too.

The agencies weren't eager to help because there is a severe mismatch between guaranty agency responsibilities and the incentives built into the way they are paid by the federal government. Just like lenders, guaranty agencies are paid according to loan *volume* rather than on a per-loan or a per-borrower basis. Helping community colleges doesn't pay the bills. Instead, the talented and knowledgeable people at guaranty agencies spend their time trying to poach high-volume schools from each other. The system is irrational and inefficient, but it

[4] State governments are not required to play any particular role in the FFEL process. If CSAC didn't exist the federal government would name a different entity, with or without any substantial involvement of California state government.

[5] The agencies confirm that the loan is guaranteed by the federal government, assist lenders in collecting loans that are delinquent, and attempt to collect on loans that have defaulted before turning those loans over to the U.S. Department of Education for collection by other contractors. The term "guaranty agency" is actually a misnomer, because they are simply intermediaries administering the federal guarantee.

pays off for some agencies and some states even if it's a net loss for taxpayers overall.

Uncertainty and incomplete coverage are unavoidable with the current design of the FFEL program. The program continues to operate this way because the lenders and guaranty agencies that do well (and even some of those that only aspire to do well) lobby Washington to keep the status quo. In the interest of good public policy, I would urge you to tell the California congressional delegation that the financial incentives faced by guaranty agencies are not aligned with the underlying purpose of the federal financial aid programs.

Private student loans

Five to 10 percent of students in California take out student loans that are not backed by the federal government. They take out private or "alternative" loans for a variety of reasons:

- They have a good credit record and were able to get a reasonable interest rate.
- They took out the maximum that they could in federal loans but needed more. (See the attached fact sheet from our Project on Student Debt, describing the various ways to access additional federal loans.)
- They didn't realize there were federal options available or that they were eligible.
- They were enrolled in a short-term vocational program not eligible for federal loans.
- They were ineligible for federal loans due to poor grades, a drug conviction while receiving federal aid, or a default on a previous federal loan.
- They found the FAFSA too daunting or did not want to fill out a government form.

The interest rates on private loans depend on the credit rating of the borrower or cosigner and can be as high as 18 or 20 percent—no better than a credit card. Generally the rates are variable, and therefore will increase when rates in the economy go up.

Borrowers with good credit records are not likely to experience problems in getting an education loan as a result of the credit crunch. However, some may have to switch lenders, and they may find that interest rates are a little higher. Students or parents with no credit history or a poor credit history will have more difficulty getting a private student loan than they did in the last few years. These sub-prime borrowers will face particular difficulty borrowing to attend technical schools with low graduation and job placement rates.

When students find that private loans are necessary to afford a particular school, we strongly encourage them to first make sure that the school is the right fit and really worth the money. Students need to be especially skeptical of vocational programs that make a selling point of bright future job prospects that will supposedly make it easy to pay off heavy loan burdens.

One way to reduce the need for private loans—at least for those students who have already taken out their maximum Stafford loans—is to increase federal loan limits. Congress included just such an increase in the bill enacted last month, which I will describe in more detail below. [6]

Recent Action by the Secretary and by Congress

With the recent turmoil in the credit markets the biggest hazard has *not* been that students would be unable to get federal student loans at all. Even before Congress acted there were already backstops designed to prevent that. The danger was that gaps in availability would emerge so quickly that students and schools would face confusion, hassles and delays as a result. Low-income students are the least able to weather those types of disruptions.

To reduce the likelihood of sudden shifts in available loan sources, Congress last month gave the U.S. Department of Education temporary authority to inject liquidity into the FFEL marketplace. Using their FFEL loan portfolios as collateral, lenders can now tap into a low-interest line of credit from the federal government that can be used to make new student loans. In addition, the government has agreed to purchase FFEL loans from banks that decide they do not want to hold them over the long term. (Most banks participating in FFEL have traditionally sold the loans they make to secondary markets.)

These steps have significantly calmed the FFEL participants. However, while the changes are palliative, they do not alter the underlying dynamics of the FFEL program: all eligible students are supposed to be able to get loans, but the lenders—and even the guaranty agencies to some degree—can pick and choose which schools and students they want to serve. If this uncertainty makes schools nervous, they might take the advice offered recently by the *New York Times* editorial board: consider switching to the Direct Loan Program.

As I already noted, to reduce the demand for private loans Congress also increased Stafford loan limits. Undergraduates this fall will be able to borrow an additional $2,000 each year in Unsubsidized loans (interest is charged during school on these loans), and the total amount of Stafford loans students can borrow as undergraduates will rise to $31,000 for dependent students, and $57,000 for independent students.

In addition, the recent legislation expanded eligibility for PLUS loans (for parents and graduate students) such that a recent difficulty in making mortgage payments would not, on its own, make the borrower ineligible.

What the state should do

State officials should be on the same page as Secretary of Education Margaret Spellings, who sent a letter to college presidents in February: "I want to

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[6] The Ensuring Continued Access to Student Loans Act of 2008, H.R. 5715, was signed into law on May 7.

reassure you that federal financial aid—grants, loans ... and work-study—will continue to be available to your students and their families." Focusing on and legitimizing exaggerated claims of a student loan "crisis" can have far more negative consequences than what is actually taking place. The worst thing that could happen would be for students to decide that they will not be able to go to college, or will need to take fewer classes or work more on the side, because they *believe* that they or their parents won't be able to get a student loan.

It is also useful to point out, as the Secretary did, that *no eligible student has been unable to get a federal loan*. This was true, is true, and will continue to be true because of the multiple fail-safe provisions in federal law.

If students being denied access to federal student loans is a concern, one place we should look more closely is the California community colleges, where fewer than three percent of full-time freshmen receive loans.

Especially at the community colleges, there are many students who severely undermine their ability to succeed in their courses because they have to work long hours to make ends meet. The best way to address this problem is to provide grant aid. While the California State University and University of California campuses have substantial institutional grant aid in addition to Cal Grants, the community colleges have virtually none. On top of that, the state is threatening to eliminate the competitive Cal Grants that go primarily to community college students. That's the wrong choice to make to balance the budget. Cal Grants to community colleges should be expanded, not cut.

Even with a large increase in grant aid, the community colleges could make better use of federal loans to improve college access and particularly college success. Community colleges are extremely reluctant to tell students that they are eligible for loans, and some even decline to participate at all in the federal loan programs (making all of their students ineligible). Some believe students "shouldn't" borrow, which is a noble if misguided instinct. Others are concerned that students will default and that the federal government will punish the school by cutting off their access to Pell grants and other student aid. They may be unaware of exceptions to federal rules that can protect them from such punishments. Those exceptions, as well as available default management strategies and the availability next year of a new income-based repayment program for federal student loans, mean that schools' worries are overblown. The state should develop strategies for community colleges to make more effective use of available financial aid, including loans if necessary, to help students focus on their studies.

Finally, as I noted earlier in my testimony, Congress needs to hear from you about how the financial incentives in the FFEL program could be aligned more closely with the needs of Californians and the needs of college students across the nation.

Again, thank you for the opportunity to testify today. My first job out of college was as the Sacramento lobbyist for CALPIRG. I lived just a few blocks from here and I appreciate having a reason to return every now and then.

Sample Financial Aid Packages

University of California, Berkeley

Student Budget (2007-8)		
Tuition and Fees	*$*	*7,165*
Books and Supplies	*$*	*1,234*
Room and Board	*$*	*13,848*
Transportation and Personal	*$*	*3,062*
Total	*$*	*25,309*

Family Income of $80,000		
Parent Contribution	$	11,067
Student Contribution	$	2,000
Term-Time Work	$	3,000
Federal Loan	$	4,160
Grants	$	5,082
Total	$	25,309

Family Income of $40,000		
Parent Contribution	$	1,265
Student Contribution	$	2,000
Term-Time Work	$	3,000
Federal Loan	$	4,160
Grants	$	14,884
Total	$	25,309

California State University, Fullerton

Student Budget (2007-8)		
Tuition and Fees	*$*	*3,342*
Books and Supplies	*$*	*1,238*
Room and Board	*$*	*7,440*
Transportation and Personal	*$*	*3,398*
Total	*$*	*15,418*

Family Income of $80,000		
Parent Contribution	$	11,067
Student Contribution	$	150
Term-Time Work	$	2,000
Federal Loan	$	2,201
Grants	$	-
Gap	$	-
Total	$	15,418

Family Income of $40,000		
Parent Contribution	$	1,265
Student Contribution	$	150
Pell Grant	$	3,000
Cal Grant B	$	1,551
CSU Grant	$	3,342
Term-Time Work	$	2,000
Federal Loan	$	3,500
Gap	$	610
Total	$	15,418

Santa Ana College (Community College)

Student Budget (off-campus without family 2007-8)		
Tuition and Fees	*$*	*508*
Books and Supplies	*$*	*1,332*
Room and Board	*$*	*10,854*
Transportation and Personal	*$*	*3,384*
Total	*$*	*16,078*

Family Income of $80,000		
Parent Contribution	$	11,067
Student Contribution	$	150
BOGW	$	508
Term-Time Work	$	2,000
Federal Loan	$	2,353
Gap	$	-
Total	$	16,078

Family Income of $40,000		
Parent Contribution	$	1,265
Student Contribution	$	150
Pell Grant	$	3,000
Cal Grant B	$	1,551
BOGW	$	508
Term-Time Work	$	2,000
Federal Loan	$	3,500
Gap	**$**	**4,104**
Total	$	16,078

Stanford University

Student Budget (2007-8)		
Tuition and Fees	*$*	*35,089*
Books and Supplies	*$*	*1,335*
Room and Board	*$*	*10,808*
Transportation and Personal	*$*	*1,995*
Total	$	49,227

Family Income of $80,000		
Parent Contribution	$	9,638
Student Contribution	$	2,000
Term-Time Work	$	2,500
Loans	$	-
Grants	$	35,089
Total	$	49,227

Family Income of $40,000		
Parent Contribution	$	-
Student Contribution	$	2,000
Term-Time Work	$	2,500
Loans	$	-
Grants	$	44,727
Total	$	49,227

Other Example Private College

Student Budget (2007-8)		
Tuition and Fees	*$*	*30,000*
Books and Supplies	*$*	*1,100*
Room and Board	*$*	*11,000*
Transportation and Personal	*$*	*2,000*
Total	$	44,100

Family Income of $80,000		
Parent Contribution	$	9,638
Student Contribution	$	2,000
Term-Time Work	$	2,500
Federal Loan	$	5,500
Institutional Grant	$	15,000
Gap	**$**	**9,462**
Total	$	44,100

Family Income of $40,000		
Parent Contribution	$	1,265
Student Contribution	$	2,000
Term-Time Work	$	2,500
Pell & Cal Grants	$	12,708
Institutional Grant	$	10,000
Federal Loan	$	5,500
Gap	**$**	**10,127**
Total	$	44,100

Note : The family with $80,000 in income would likely be able to claim a federal tax credit of $1,650 on any tuition expenses not covered by state and institutional grants (for the first two years of college).

Source: The Institute for College Access & Success, based on publicly available data.

Federal Student Loan Amounts and Terms 2008-9		
Basic Eligibility Requirements		U.S. citizens or permanent residents, enrolled at least half time in a qualified program at a participating school, not in default on a prior student loan, and not convicted of a drug offense while receiving prior federal financial aid. Total aid, including student loans, cannot exceed school's total cost of attendance (tuition & fees, room & board, transportation, personal & misc. expenses).
Stafford	**Eligibility**	No credit check. FAFSA required. Subsidized loans require financial need; Unsubsidized loans are available regardless of need.
	Annual Loan Limits	Dependent students: $5,500 as freshmen (including up to $3,500 Subsidized); $6,500 as sophomores (including up to $4,500 Subsidized); $7,500 as juniors and seniors (including up to $5,500 Subsidized).
		Independent students: $9,500 as freshmen (including up to $3,500 Subsidized); $10,500 as sophomores (including up to $4,500 Subsidized); $12,500 as juniors and seniors (including up to $5,500 Subsidized).
		Graduate students: $20,500 (including up to $8,500 Subsidized).
	Aggregate Loan Limits	Dependent students: $31,000. Independent students (undergraduate): $57,500. Graduate & Professional students: $138,500 (or $224,000 for certain medical training) including undergraduate borrowing.
	Interest rate	6.8% on Unsubsidized loans. On Subsidized loans, no interest is charged during school and in some deferment periods; in repayment, the rate is 6.0% for undergraduate students and 6.8% for graduate students.
	Fees	2% (see Discounts)
PLUS	**Eligibility**	Available regardless of need to parents of dependent students (Parent PLUS) and to graduate/professional students (Grad PLUS). Credit check must show no delinquencies in the previous 90 days (some exceptions for extenuating circumstances) and no bankruptcy in the previous five years. FFEL lenders may apply stricter requirements but may not deny a loan based on the absence of a credit history. The credit requirement can be met by a cosigner. For Parent PLUS the FAFSA is at the school's option.
	Loan Limit	Total cost of attendance minus other financial aid. No aggregate maximum.
	Interest rate	7.9% in the Direct Loan Program, sometimes matched by lenders in FFEL, where the maximum rate is 8.5%.
	Fees	4% (see Discounts)
Rate reduction for automatic electronic payments		0.25% interest rate reduction offered by the Direct Loan Program and by many FFEL lenders. (Note: a 0.25% interest rate reduction is equal in value to about a 1% fee at loan disbursement).
Discounts		Some FFEL lenders/agencies offer discounts to some borrowers, such as covering a portion of the fee and/or offering a principal reduction or interest rate reduction tied to on-time payments. In the Direct Loan Program, fees are reduced by 1.5% at disbursement; the 1.5% is charged later if the borrower fails to make the first 12 payments on time.
Income-Based Repayment		Available in both FFEL and Direct Loan Programs starting July 2009. Income-Contingent Repayment is available now in the Direct Loan Program.
Loan Forgiveness		New 10-year public service loan forgiveness program available only in the Direct Loan Program (includes Grad PLUS). Teacher loan forgiveness programs (Stafford only) available in both FFEL and Direct.

Source: The Institute for College Access & Success.

THE PROJECT ON STUDENT DEBT

Student Loan Options in a Tight Credit Market

The current credit crunch has students and parents concerned about whether they will be able to get the loans they need to cover college costs. The good news is that *federal student loans are and will remain widely available to students and families at all income levels*. These loans come with government-guaranteed benefits: affordable, fixed interest rates; substantial borrower protections; and new repayment and forgiveness options. However, the small percentage of undergraduates who use private, non-federal loans are likely to face stricter credit standards and possibly higher prices. Students and parents should only consider private loans as a last resort because of their high risks and costs.

To help people make the most of their student loan options, here are practical and creative answers to some of the most common questions and concerns.

Common Concern	Actual Options
"I'm not needy enough for government grants or loans."	Federal Stafford loans are available regardless of family income. The rate is fixed (currently 6.8%) and comes with a wide range of repayment options. Depending on your level of need, you may be charged interest while in school, but these loans are still much safer than private loans.
"I don't have a good credit record."	There is no credit requirement or credit check to get a federal Stafford loan.
"I need more than the maximum Stafford loan."	Ask the college if it has any federal Perkins loans or other types of aid, including grants and scholarships, for students like you.
"The school has no Perkins funds available to supplement my Stafford loan."	If you have good grades and there is a remote chance you might someday be a teacher, you can get a federal TEACH Grant – which is actually a type of Stafford loan.
"I don't qualify for a TEACH grant."	Most parents can get a federal PLUS loan (at a fixed rate of around 8%) for any costs not already covered by grants and your own loans.
"My parents don't want to borrow."	Offer to split the cost of repaying a PLUS loan with your parents, and put it in writing. If they have good credit, another option is for them to cosign a private loan for you – this may help you get a good interest rate, but is still riskier for both you and your parents than federal loans.
"My parents don't want to put their income information on the FAFSA."	There is no federal requirement to fill out a FAFSA to get a parent PLUS loan, although some colleges require it. Contact your financial aid office to learn about your college's policy and how to proceed.
"My parents were denied a PLUS loan because they were delinquent on their mortgage. They tried two different lenders."	If your parents have serious credit problems and can't get a PLUS loan, the financial aid officials at your school can nearly double your eligibility for federal Stafford loans. If your new undergraduate Stafford maximum of $57,500 is still not enough, consider other ways to reduce costs, including other schools.
"I can't apply for federal aid because I'm not in contact with my parents."	Talk to the financial aid officials at your college. Depending on your situation, they may be able to override the requirement to provide your parent's financial information.

For more consumer tips about borrowing and repaying student loans, check out our other fact sheets at www.projectonstudent.org.