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# Obama proposes changes to student loan programs [1]

Submitted by Libby A. Nelson [2] on October 26, 2011 - 3:00am

WASHINGTON -- President Obama today will announce a plan to consolidate federal student loans for millions of borrowers and expand income-based repayment for current students — both steps he will take without input from or action by Congress, amid rising concern about student debt.

Together, the two changes — part of the president's package of economic measures designed to be enacted by executive order — will affect about 7 million of the federal student loan program's 36 million borrowers. Even before the changes were announced Tuesday afternoon, Congressional Republicans were already questioning whether the administration had the authority to make them.

The majority of borrowers affected will be students who borrowed money under both the Federal Family Education Loan Program, when banks issued federal student loans and collected government subsidies, and the Direct Loan Program, under which the federal government lends money directly to students.

The government began originating all loans through direct lending in 2010, when a provision to eliminate bank-based student lending was included in the administration's health care overhau [3]l. But many students who were enrolled at the time of the change have loans in both programs, meaning they make two payments. The Education Department has said these 5.8 million borrowers are more likely to default, though why is a matter of some dispute. Administration officials attribute it to the fact that borrowers must make payments to two or more entities, while others say the Education Department has failed to fully replace the support for borrowers and colleges that lenders and guarantee agencies had under FFEL.

The consolidation program would combine the two loans into one direct loan and reduce the interest rate by up to 0.5 percent: a 0.25 percent reduction as a reward for consolidating, and a 0.25 percent discount for borrowers who enroll to make automatic payments. (Borrowers who have only a direct loan are already eligible for the automatic payment discount.) Borrowers eligible for consolidation will be notified in early 2012.

The administration also proposed changes to the income-based repayment program, which allows borrowers to repay on a sliding scale if their payments exceed 15 percent of their discretionary income. The change would lower the qualifying debt-to-discretionary-income ratio to 10 percent. Outstanding loan balances would be forgiven after 20 years, five years earlier than under the current arrangement. Congress previously approved legislation that would let these changes begin in 2014, but President Obama plans to change that start date to 2012.

The changes to income-based repayment would apply only to current students. But administration officials said they hope they will draw more attention to the existing program as well: only about 450,000 borrowers are currently enrolled, although administration officials said many more could benefit.

In remarks to reporters Tuesday, Education Secretary Arne Duncan portrayed the move as building on the administration's elimination of bank-based lending in 2009. Just a few hours earlier, during a hearing on the transition from bank-based loans to subsidized loans, Rep. Virginia Foxx, a North Carolina Republican who heads the higher education subcommittee of the House of Representatives Committee on Education and the Workforce, argued that that change hurt customer service for students, and questioned the administration's authority to switch more students to direct lending by executive order.

"I'm wondering if the department is moving forward with this proposal through executive fiat, and if this is the case, what specific authority does the department have to do this administrative action?" Foxx said.

Department officials said the changes to the income-based repayment program have already been authorized by Congress. Students with loans split between the FFEL program and the Direct Loan program have also been able to consolidate their loans for more than a year, and the Higher Education Act gives the department the authority to offer incentives for students repaying their loans.

Still, the administration had hoped to pursue consolidation through legislation: Obama's 2012 budget proposal had included a similar program to encourage split borrowers to consolidate. Officials said they changed course because they did not believe the Republican-controlled Congress would act to make the changes.

**Focus on Direct Lending**

The hearing Tuesday morning focused on difficulties that colleges encountered while switching to the direct loan program. That transition was sometimes uneven, officials from Baker University, Denison University and Kennesaw State University said. In some cases, customer service or technical support was lacking, and college employees are devoting more time than before to helping students with aspects of their loans.

Still, the administrators gave overall positive reports of the program. None said they would want to see bank-based lending reinstated. By the end of the hearing, representatives on both sides of the aisle commended the Education Department for a relatively smooth shift, even though several Republicans said they disagree with the overall philosophy of direct lending, which they viewed as a government takeover of the loan program.

The increasing interest rates on federal loans, though, came in for criticism. Student loans have become a profit center for the federal government [4], which borrows the money at a low rate and lends to students, who repay at a higher one. In the past, much of the difference went to the banks in the form of lender subsidies, a reality that drew sharp criticism from advocates for students.

But the government now keeps the difference, channeling some of the profits into financial aid programs and most of the rest toward deficit reduction (with some even flowing to administration priorities like early childhood education, as in the 2009 health care law). Once more direct and bank-based loans are consolidated, and when the student loan interest rate increases to 6.8 percent next year (when a several-year effort to halve the rate ends [5]), federal student loans will become even more lucrative for the government.

Department officials said that the consolidation and expansion of income-based repayment will pay for itself, with some of the subsidies presumably supporting the loosened income-based repayment rules. They did not say what would happen with any leftover funds from student loan repayment.

An interest rate of “6.8 percent when the federal government is borrowing at less than 1 percent can create a pretty big slush fund,” said Rep. John Kline, a Minnesota Republican who is the committee’s chairman, said during Tuesday's hearing. “It is a slush fund. I think it was a mistake to do that.”

Some Democratic representatives, including Robert Andrews of New Jersey and John Tierney of Massachusetts, proposed basing the interest rate that students pay on the interest rate the government is charged, plus whatever percentage would be necessary to cover the cost of loan defaults. “Hopefully we can work with them to lower the interest rate further,” Tierney said, referring to Kline and Tennessee Republican Phil Roe.

As more loans come under the government’s purview, those concerns are likely to increase. Student loans are “a very important resource that we provide,” said Rep. Todd Russell Platts, Republican of Pennsylvania. Platts supported the switch to direct lending in committee, although he did not vote for its inclusion in the health care law.

Any profits from lending should be used to expand financial aid programs, he said, adding that Congress should be “ensuring that the assistance is available, and ensuring that any profits or excess funds are put back into investing in students, not going into private hands or elsewhere.”

**Growing Pressure on Loans**

Concern about student debt has reached a fever pitch in recent weeks. Student loans are frequently mentioned by protesters in the Occupy Wall Street movement. A petition started by lawyer and debt activist Robert Applebaum on "We the People," the White House’s new website for petitions, gathered more than 31,000 signatures in support of forgiving all student loan debt. [6]

The administration’s proposals are relatively modest in comparison. But officials billed them as a response to the public outcry, calling the petition the first to achieve a White House response. “These individuals have rightly pointed out that the weight of this debt is preventing graduates from all over the country from achieving their dreams,” said Melody Barnes, a domestic policy adviser.

Meanwhile, the newly established Consumer Financial Protection Bureau announced a model information sheet for students who are accepted to college and considering their financial aid options. It emphasizes how much students will have to pay per month after graduation and shows college costs in comparison with similar institutions. The Education Department will eventually ask colleges to use the worksheet as a model.

Advocacy groups generally praised the president’s proposals. “Many more borrowers are struggling to keep up with their payments in these tough economic times and could benefit from IBR and the proposed Pay-as-You-Earn option,” the president of the Institute for College Access and Success, Lauren Asher, said in a statement. Since only direct loan borrowers are eligible for public service loan forgiveness, consolidation will open that option to others as well, Asher added.

But guarantors — who used Tuesday’s hearing to air grievances about the switch to direct lending, saying they provided services that the government cannot — are likely to be less pleased. “We are troubled by the apparent decision of the department to foreclose the possibility that … guarantors can provide supplemental support to Direct Loan borrowers,” the National Council of Higher Education Loan Programs said in a statement. “Given the troubled student loan landscape, the [Education Department] should want to leverage the experience and local presence of the nation’s guarantee agencies.”

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