



National Direct Student Loan Coalition

Reauthorization of the Higher Education Act

Proposals for Legislative Change

September, 2013

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Executive Summary

Members of the National Direct Student Loan Coalition work to educate legislators and the public about issues related to student aid and student loan policy and to support all students who must borrow to achieve higher education goals. We serve as the voice of financial aid administrators in student loan policy and operational discussions while advocating state-of-the-art practices at the Department of Education.

It is in that context that we offer the following proposals for consideration during the reauthorization of the Higher Education Act. We appreciate the opportunity to provide input for this process and would welcome an opportunity to discuss our proposals with you.

The following provides a brief description of the issue and recommendations. A more thorough discussion of these recommendations is available on our website at www.directstudentloancoalition.org

Simplify the Federally Held Loan Servicing Environment by mandating contractor anonymity and limiting the number of contractors to five or fewer.

- Require that federal contractors who service loans act as invisible agents of the federal government with identical processes and policies
- Borrowers must have a single point of contact for all loan repayment activities with one web portal and one phone number for account access which utilizes available technology to route the borrower to the contractor
- Transfer of loans can be confusing, requiring the borrower to reinitiate automatic payments and on line access and contributes to delinquency
- Prohibit contractor “branding” and other marketing of the contractor’s products to the borrower
- Service levels, loan terms and borrower benefits must be equal across contractors
- A limited number of contractors provides for healthy competition; too many contractors increase complexity and administrative cost

Establish StudentLoans.gov as the Single Portal for All Borrower Transactions

- Focusing borrower activity to a single site improves the simplicity and transparency of the federal loan process for the borrower
- Borrower information or inquiries initiated through this single portal can be transferred or assigned to the appropriate loan servicer and the transfer can remain invisible to the borrower

- A single portal eliminates the confusion that often occurs when loans are transferred between servicers since these transfers can remain invisible to the student
- This approach can reduce the cost of federal servicing since only one borrower 'front end' has to be created and maintained

Establish a Single Income Driven Repayment Option as the default repayment plan for all students.

- Monthly payments should not exceed 10% of the amount by which adjusted gross income exceeds 150% of the poverty level
- Interest should accrue but not be capitalized and should be capped at 50% of the original principle balance
- Utilize payroll deduction and IRS withholding processes to facilitate collection of monthly payments with annual reporting and reconciliation through the Department of Education
- Unpaid principle and interest should be forgiven after 20 years or 10 years for those engaged in public service positions
- The complexity of loan deferments and forbearance could be eliminated as could much of the current expense of federal loan servicers
- Borrowers could be given an option for accelerated payment through a 10 year standard repayment plan
- Cost savings could be used to provide programs that would incentivize current borrowers in the Direct and FFEL Programs to convert their debt to the new repayment option

Loan Origination Fees Should be Eliminated in the interest of transparency and simplification.

- With an interest rate structure that covers an appropriate portion of the cost of the program additional fees are not necessary
- Loan fees add to the complexity of the program

Federal Student Loan Interest Rates should flow in an equitable way to all borrowers and must promote access and completion. The following features would support these principles:

- The rate should be indexed to a Treasury Security
- The rate should include an amount which:
 - Covers an appropriate portion of the cost of the program
 - Allows for borrower subsidies
 - Reflects the difference in servicing cost for enrolled versus serviced borrowers
- The rate should be market driven and adjusted annually
- The rate should include built-in consumer protections in the form of interest rate caps that protect against excessive annual fluctuations and balance risk for the borrower and program cost

Increase Undergraduate Loan Limits to allow first year borrowers or students in a one year program to borrow up to \$9,500; students beyond their first year should be allowed to borrow up to \$12,500 and the cumulative limit should be raised to \$47,000.

- Loan limits have not been raised since 2005
- Current limits are not adequate forcing many borrowers into more costly private loans
- Adequate annual and cumulative loan limits can encourage use of a single source for loans for education and enhance the potential for successful repayment
- Institutional flexibility to restrict annual or cumulative borrowing using professional judgment should be allowed to recognize desirable limits based on factors specific to an institution or individual borrower

Allow Federal Loan Consolidation to All Borrowers at Least Once During Repayment

- If other proposals to simplify loan repayment and interest rates are included in Reauthorization, loan consolidation would only be used by a portion of prior borrowers and would provide some equity to their situation
- Borrowers who obtained their loans during periods of high interest rates should not be forced to carry high interest rates for the life of the loan
- Offering a one-time option prevents continual reconsolidation as interest rates fluctuate
- To facilitate the consolidation process and support an informed decision, an electronic process utilizing borrower information in current federal systems should be mandated

Eliminate the 150% of Program Length Limit on Eligibility for Subsidized Loans

- Current satisfactory academic progress requirements and cumulative maximums limit a borrower's eligibility for loans
- Reduce complexities for borrowers by managing the cost of federal subsidies in the interest rate structure and within the established regulations that limit eligibility
- Limiting borrowing for retraining or career change does not support the need for a well-educated and nimble workforce

Eliminate the Requirement that Loans for Students in the last term of their Undergraduate Career be Prorated

- This requirement is contrary to the goal of college completion
- Reduces available resources for students at the end of their academic program
- Current annual and cumulative limits on federal borrowing make this requirement unnecessary

Reduce the Need for Private Education Loans and Re-establish Bankruptcy Protections for Borrowers

- Increase federal loan limits to provide one source for education loans
- Require school certification for all private loans to prevent over borrowing and provide opportunities for borrower education
- Reinstate bankruptcy protections for private education loan borrowers which will result in more judicious credit decisions by lenders

Work within the Tax Code to Eliminate Loan Forgiveness as a Taxable Event

- Change the statute to mirror the Perkins Program where loan forgiveness is not taxed
- Income based repayment programs which offer the possibility of loan forgiveness are typically beneficial to borrowers with low to moderate incomes and the 'forgiveness penalty' is an unreasonable cost for these borrowers
- Though we recognize that this is an issue for committees with jurisdiction over the tax code, there appears to be a common interest to be addressed by committees working on Reauthorization of the Higher Education as well

Create One Federal Loan Program within Title IV of the Higher Education Act to Simplify the Process for Borrowers and Improve their Potential for Success

- Reinvention of the Perkins Loan Program as part of the Unsubsidized Federal Direct Loan Program can bring simplicity to the federal loan programs while increasing available funding
- A simplified lending landscape lends itself to improved transparency for the borrower and provides an opportunity to implement innovations in the collection process using employer withholding
- A single federal loan program also creates an environment where borrower benefits and program costs can be more easily understood from a meaningful public policy view
- Incorporating concepts suggested here regarding borrower benefits, loan servicing and consumer protections would be important features of a single federal education loan program

Expanded Discussion of Reauthorization Proposals

The proposals for consideration put forth by the National Direct Student Loan Coalition for consideration during the reauthorization of the Higher Education Act as presented in the Executive Summary are expanded on in the following pages.

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Simplify the Federally Held Loan Servicing Environment

The current Direct Loan servicing environment is fraught with confusion, frustration and increasing default rates for student borrowers. There is an inherent flaw with the current multiple contractor environment—borrowers do not understand who holds their loan. Initially Direct Loan had one contractor, identified as the US Department of Education to borrowers. As of June 2013, there are 17 contractors servicing Direct Loans and marketing their companies to student borrowers. The number of contractors is set to double in the near future as more of the not-for-profit servicers become operational.

Contractors are inconsistent in their business processes and communication to borrowers. The multiple contractor system, in the growing numbers and present form, is costly to administer and inefficient. The two year national cohort default rate has increased in every year that we have had a multiple contractor environment. It's time to fix the multiple contractor system to simplify loan repayment for borrowers and reduce default rates.

Until another means of repaying student loans is available (such as IRS payroll deduction) the following changes are needed to restore clarity and simplification for students:

- Borrowers must have a single point of contact for all loan repayment activities
- Students should be given one web portal and phone number for loan servicing, with behind the scene technology routing the borrower to their contractor
- The identity of contractors should be invisible to the borrower
- The contractors should be mandated to use only the Department of Education's logo and name on any communication to the borrowers
- Contractor "branding" and other marketing of the contractor to the borrower should be prohibited
- Service levels, loan terms and borrower benefits must be equal and uniform
- Consistent processes and forms for common requests like deferment and forbearance should be the same for all contractors and available through electronic means
- Calculations of interest, fees, interest capitalization, and application of payments to principal and interest should all be standard and consistent among the contractors
- Performance measures should be relevant and uniformly applied to all contractors
- We support healthy competition among a limited number of contractors--too many contractors increase the complexity of the system and taxpayer cost

The Coalition also recommends that the mandatory participation of not-for-profit contractors previously approved by Congress should be eliminated. These mandated contractors do not provide value for borrowers, create confusion and require a taxpayer subsidy that is not efficient or justifiable.

Establish StudentLoans.gov as the Single Portal for all Borrower Transactions

Studentloans.gov is a portal for borrowers to complete many requirements of a Federal Direct Stafford or PLUS Loan including:

- Master Promissory Note
- Entrance Loan Counseling
- Exit Loan Counseling
- Financial Awareness Counseling Tool
- Loan Consolidation
- Income Based Repayment Application

Borrowers are familiar with this web site and recognize it as the portal for their federal loan activities. For continuity and simplicity this portal should be expanded to serve the borrower from application through repayment. Studentloans.gov should be enhanced to include a single portal to provide links for borrowers to:

- Review all loan history (NSLDS)
- Obtain forms necessary to complete deferments or forbearance
- Calculate repayment amounts for different repayment plans
- Contact their loan servicer
- Provide links to loan servicer systems that allow borrowers to access their account

When a student or parent borrower authenticates through studentloans.gov, this information should enable the borrower to access all their student loans.

Establish a Single, Income-Driven Repayment Option

The availability of multiple federal loan repayment options was intended to offer borrowers options to manage repayment of their federal student loans. Assumptions about the best repayment plan for students who failed to choose between existing options are less valid as average debt levels increase and employment opportunities decrease. We suggest a change in the paradigm: place all borrowers on an income driven repayment plan.

This proposed change will greatly streamline loan repayment, cutting costs to the government and reducing confusion for students. Defaults will be reduced and student borrowers will be treated consistently with borrower benefits for low income available to all who need this assistance. The proliferation of loan repayment options do not serve borrowers well, we need a simplified approach and suggest the following:

- All borrowers would be placed in one income based repayment plan; borrowers could be presented with the standard repayment amount needed to repay within 10 years, and can opt to pay this higher amount (or any other prepayment) at any time.
- Loan payments will be collected through payroll withholding to the IRS and passed through to the US Department of Education. Payment amounts will be reconciled annually with the US Department of Education issuing a bill to the borrower if not enough was collected based on annual income or if more collected than required, the borrower can opt for a refund or use the balance to reduce principal.
- Loan repayments are based on Adjusted Gross Income. No more than 10% of income above 150% of the poverty level based on family size will be assessed.
- Interest would not compound during repayment and would stop accruing once it equals 50% of the loan's balance at graduation.
- After 20 years of qualifying payments/months of economic hardship deferment, remaining loan balances would be forgiven. Those employed in full-time public service would qualify for loan forgiveness after 10 years.
- Loan deferments or forbearance for periods of unemployment or military service would be eliminated as repayment amounts would be calculated on the lower income of the borrower resulting in zero or low payment required.
- Loan repayment would begin 6 months after the student leaves school (or ceases to be enrolled at least half-time).
- If income is not verifiable through a tax document, then another means to assess payment will need to be developed.
- Current borrowers in the previous FFEL, IBR, ICR, standard, extended, graduated or other repayment plans would be given an incentive (reduction of interest rate of 1% or 2%) to convert to this loan repayment plan. This new IBR plan would be available to all borrowers, regardless of when they took out their existing Stafford loans.
- Because there is one loan repayment system, the need for the extended network of current servicers is eliminated. Competitive contracts for a small number and different types of contracts for the IRS and US Department of Education would need to be developed and issued.

Loan Origination Fees Should Be Eliminated

Loan fees add to the complexity of the federal loan program for borrowers and make the true cost of the loan less transparent. Borrowers understand that the interest paid on the loan is the cost of borrowing. Origination fees are similar to points charged for a mortgage—they are an added cost of borrowing but one that is obscure to the borrower and often misunderstood. A common misconception is that the school is keeping part of their loan.

If, as proposed in another section of this document, the federal interest rate structure is amended to be based on a treasury security with an index that balances the appropriate subsidies for the borrowers and cost to the taxpayer, additional fees would no longer be necessary.

Just as many other measures have been adopted to assist borrowers with understanding the terms and conditions of the loan, we urge elimination of the origination fee to simplify student loan pricing.

Federal Student Loan Interest Rates

Recent legislation that established the variable interest rates for federal student loans provided relief for borrowers and established a starting point for further improvements to the interest rate structure that could support program stability and borrower confidence. Given concerns about future rates under this legislation we expect that the discussion about federal student loan interest rates may continue during the process of reauthorizing the Higher Education Act. It is for that reason that our recommendations regarding federal student loan interest rates is included here.

Guiding Principles:

The National Direct Student Loan Coalition recognizes that there are multiple public policy implications for federal loan subsidies and interest rates. The following principles guide the interest rate proposal presented below:

- Interest rates must promote student access and completion
- Interest rates should be based on a formula that is permanent and provides a long term solution
- Interest rates should balance the costs to the federal taxpayers and to students
- Rates should flow in an equitable way for all borrowers—one cohort of borrowers should not subsidize another
- Rates should reflect the government’s cost of borrowing plus a factor to cover loan servicing and an appropriate share of borrower benefits
- Variable interest rate should be adjusted on an annual basis and clearly disclosed to all borrowers
- Rate needs to be set in the context of the total cost of borrowing which include
 - Elimination of the origination fee
 - Interest subsidy
 - Loan forgiveness

Recommendation: We suggest the following interest rate structure based on these principles:

Feature: **The interest rate should be indexed to a treasury security.**

Rational: The rate on treasury securities reflects the government’s cost of borrowing and recognizes that student loans are federal investments. A market driven rate keeps the rate fair to the borrower and taxpayer as the cost of capital fluctuates.

Principle: Promotes access by assuring the best rate possible and keeping interest rates relevant to market rates. Historical rates can indicate how rates might fluctuate during the life of the loan and provide assurances that are measurable.

Feature: **The index should include an amount that covers an appropriate portion of the cost of the program, allows for borrower subsidies, and reflects the variance in cost between borrowers who are enrolled and borrowers who are in repayment.**

Rational: Program costs are well documented and an index can be developed that includes an amount to cover an appropriate portion of the cost of the program and limits the liability of the taxpayer.

Principle: The appropriate index can balance the subsidies to the borrower with the cost to the taxpayer. Simplification could be achieved if the rate structure results in the right 'price' for a loan thus making other fees unnecessary.

Feature: **The rate on all loans should be market driven and adjusted annually.**

Rational: A rate that is adjusted annually on a fixed date protects the borrower and the taxpayer with costs that most closely reflect the cost of capital. It provides simplicity for the borrower since all loans will have the same rate. A true variable rate assures that all borrowers are treated equally. A rate that is variable but locked for each cohort of loans results in some borrowers being overcharged while others are undercharged. With market based fluctuations in the rate there will be no need to artificially adjust the rate through legislation.

Principle: A truly variable rate provides a long term solution that protects the interest of both the borrower and the taxpayer. It promotes persistence and completion because the cost of financing is market based and fair to all parties. Rates that adjust annually can be disclosed with certainty that the rate will exist for a year.

Feature: **To protect borrowers, consumer protections should be considered with a view toward the cost of these provisions and tradeoffs in risk. Options might include a cap on the amount interest rates can go up or down in a one year period (such as +/- 1 %), a cap on overall rates, and differentials between the various federal loans; subsidized, unsubsidized and PLUS/Grad PLUS.**

Rational: Consumer protections generally introduce added cost to the programs however a cap limiting annual fluctuations to +/- 1% can add a level of fairness to the rate, make changes in cost and revenue more predictable and deter the impulse to react legislatively to market behavior. While an overall cap may appear to be a more desirable protection for borrowers it may never be necessary and would add cost. Protecting the borrower from large fluctuations in monthly payments year to year may be more helpful to borrowers.

Principle: Though absence of a cap makes the rate truly market driven and avoids the temptation to legislatively change the rate during periods of volatility providing a basic consumer protection that sets some limit on rate fluctuations should be considered for its effect on access and persistence.

Summary

The interest rate for the federal loan programs should be a variable rate tied to a treasury security plus a factor to reflect the administrative cost of the program and subsidy for borrowers. The rate should vary annually on all of a borrower's outstanding federal loans with some consumer protections such as a limit on annual changes (for example +/-1 %). Additional loan fees should not be necessary if the rate correctly reflects reasonable subsidies and costs.

The rate structure suggested here supports the needs of student borrowers for adequate and necessary subsidies to promote the goals of educational access, persistence and program completion and the needs of taxpayers by providing adequate revenue to cover the appropriate level of cost and subsidies in the federal loan programs.

Increase Undergraduate Loan Limits

The current loan limits on Direct loans have been largely untouched since 2005. When loan limits on Stafford loans do not increase, students are forced to resort to much more expensive parent or private loans.

The National Direct Student Loan Coalition supports the idea of increases in loan limits. First year borrowers should have the ability to borrow at least \$9,500 / year (an increase of \$4,000 from the current limits) and after the first year, the limit should increase to at least \$12,500. In order to accommodate these new limits, the aggregate undergraduate limit should be adjusted.

Schools that wish to limit borrowing should have that ability and be able to do so for individual cohorts within their population. For example, some low cost institutions, or institutions that can meet most of a student's need with non-loan sources, should have the statutory authority to limit annual borrowing for their students. Schools may use criteria such as year in school, or satisfactory academic progress to identify the populations who have their loan amounts limited.

Allow Federal Loan Consolidation to All Borrowers at Least Once During Repayment

Loan consolidation offers borrowers an opportunity to obtain benefits not available when their original loan was obtained, make management of loan obligations more reasonable by bringing all loans into a single note and sometimes allows the federal government to bring more loans under the ‘federal direct’ umbrella. Loan terms and interest rates can vary significantly depending on when the loan was originated. Allowing borrowers to consolidate once could allow borrowers to take advantage of more favorable terms or options not originally available. Limiting the number of times a borrower can consolidate will make the borrower more judicious about when to employ the option and limit federal liability from a constantly moving portfolio.

Building on the notion of a single portal for all loan services, we suggest utilizing StudentLoans.gov as the vehicle for borrowers to apply for loan consolidation. From this portal, borrowers can access their loan data on the National Student Loan Data System (NSLDS) and be presented with all their federal loans. A borrower could then select which loans they would like to include in a consolidation loan.

To support an informed consolidation decision we support adding functionality to StudentLoans.gov that would:

- Allow the borrower to access information about all their outstanding federal loans through NSLDS
- Allow the borrower to select all loans to be included in the consolidation
- Present the monthly payment amount for each of the repayment options available to the borrower based on the loans selected for consolidation
- Allow the borrower to select their repayment option for the consolidated loan
- Once the student has selected their repayment option, application information could be provided on-line and the borrower’s rights/responsibilities and other legal requirements of the application process could be provided
- The borrower could then complete the promissory note with an electronic signature similar to that required of the Master Promissory Note under www.studentloans.gov.
- This on-line process could also be used to collect information from the borrower’s various loan holders so that the Loan Consolidation Verification could be completed
- The borrower could be notified by the loan servicer once all of the original loans are paid in full with the consolidated loan
- The consolidation servicer then notifies the borrower of the completion of the process and initiates the repayment process

A limited option for loan consolidation, supported by an efficient, electronic application process, offers borrowers an opportunity to manage their federal loans and supports successful repayment.

Eliminate the 150% of Program Length Limit on Eligibility for Subsidized Loans

The recently enacted limit on eligibility for subsidized federal loans to 150% of program length should be eliminated. Eligibility criteria for federal loans should follow the general eligibility criteria established for other Title IV financial aid programs. This helps to simplify the programs and allow potential recipients to make decisions about access and attendance based on their eligibility for support.

The following points are offered in support of this recommendation:

- Current Satisfactory Academic Progress requirements for the Title IV federal aid programs and cumulative loan maximums already limit the amounts students can borrow and length of eligibility.
- The additional limitation imposed by this regulation is not necessary and creates unnecessary program complexity for applicants.
- These requirements create costly monitoring and implementation processes, both for schools and the Department of Education.
- For students who change programs or find job retraining necessary, the provisions are especially punitive.
- The cost of federal subsidies should be managed through the appropriate pricing of student loans as a factor in the interest rate calculation not by creating regulatory complexities.
- This provision was enacted to affect scoring and create savings to pay for the extension of the 3.4% interest rate for subsidized loans for one year.

Eliminate the Requirement that Loans for Students in the Last Term of Their Undergraduate Career Be Prorated

If the loan proration requirement was enacted to reduce student indebtedness or encourage program completion sooner, data from the initial set of Experimental Sites could support the fact that these goals were not accomplished by this requirement. We suggest that:

- The required proration of loans for one-term graduating seniors is contrary to the goal of college completion and an unnecessary administrative burden for schools
- In a student's final term they should be subject to the same borrowing limits as all other students
- Students who graduate default at much lower rates than those who do not graduate

Additionally, federal student loan borrowing is already limited overall by aggregate and annual limits and further limitations are unnecessary. Restriction of federal loan eligibility in a student's final term may force a borrower into more expensive and more risky private borrowing.

Elimination of required loan proration will serve the needs of borrowers by continuing critical federal student loan access at a critical point in their educational career and the federal goal of program completion.

Re-establish Bankruptcy Protections for Private Student Loan Borrowers

Private student education loan debt has grown exponentially in the recent past and many students have borrowed in excess of what they are able to repay. Therefore, steps must be taken to reduce inappropriate and unwise student borrowing. The National Direct Student Loan Coalition proposes the following:

- Private education loans should regain bankruptcy protection. If this is done, we foresee the following improvements:
 - a. Lenders will be more judicious when making decisions about extending credit for educational purposes, and loans will therefore be made to those who appear more likely to have the ability to repay the loans.
 - b. When a borrower of an education loan encounters unforeseen difficulties in repayment, they may avail themselves of loan discharge in bankruptcy as a last resort.
- Instead of self-certification, schools should be required to certify student eligibility for private education loans, including assurance that the loan will not exceed Cost of Attendance minus other financial aid/education loans. This would prevent over-borrowing and borrowing private education loans for non-educational purposes.

Eliminate Loan Forgiveness as a Taxable Event

Income driven repayment options are included in the current repayment choices available to federal student loan borrowers. These options recognize that either through choice or circumstance, a borrower's income may be limited and thus affect the ability to retire federal student loan debt. We do not believe it was the intent of those who authorized these provisions to create an unreasonable tax burden for those who legitimately qualify for this benefit.

Though we recognize this change may need to be accomplished through the tax writing committees, we encourage the education committees to focus attention on this issue and consider the following:

- If a borrower, after years of reduced payments because of low income, still has a balance due, adding the forgiven amount to their taxable income would be a huge burden, creating tax liability that is beyond their capabilities to pay.
- The statute should be changed to mirror the Perkins Loan program in which forgiven loan amounts are not taxable.

Create One Federal Loan Program within Title IV of the Higher Education Act

The complexities in the federal student loan programs are overwhelming for students, parents, schools, and loan servicers. The inherent difficulties are the result of both legislation and regulation and result in confusion at best and unnecessary defaults at worst.

In order to streamline and simplify the federal student loan programs without adding significant cost to taxpayers, the National Direct Student Loan Coalition proposes that the Federal Direct Student Loan, and Federal Perkins Loan programs be dramatically changed. The result of the changes will be:

- Greater understanding of the terms and conditions of any federal debt students incurred, both during in-school periods and in repayment
- Simplicity of repayment resulting in a decrease in default rates
- Improvement in actual and perceived fairness of terms and conditions of federal student loans both from current and long-term perspectives

We understand that there have been a number of proposals as to how one federal student loan program could be accomplished and how it would work. There are numerous stakeholders who have varied interest in how one federal loan program could impact their eligibility, access to funds, administrative efforts and profits. We suggest that the interests that should guide the development of a single federal loan program be driven by the following:

- Assure that student borrowers have access to federal funds that support their educational goals
- Develop loan terms and conditions that support student success in educational attainment and loan repayment
- Avoid unnecessary legislative constraints and structure program requirements that support administrative capability for schools and the Department of Education
- Create a cost / benefit structure that supports taxpayers interests with investment in human capital

Members of the National Direct Student Loan Coalition are anxious to work with the Education Committees on this project.

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