Five Ideas that Could Change Student Aid

By Justin Draeger

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One Student, One Loan

Topics that were once red hot become old news pretty quickly in higher education. Ideas like using federal tax forms instead of the FAFSA to determine student need, or collapsing all federal student aid grants into a "super-Pell Grant" have been around longer than some in the financial aid profession itself. Often, old ideas are merely tweaked and then repackaged as new ideas.

In September, the "Rethinking Student Aid" group released a series of recommendations to overhaul the student aid system. Some of the recommendations, like lowering parent PLUS loan interest rates, were nuanced changes to the current system. Others, like creating government-sponsored savings accounts for Pell-eligible families, were more drastic. Still, the group's recommendations focused entirely on - student aid and failed to address new ideas that focus on the burgeoning numbers of nontraditional and graduate students.

"I would have liked to have gone much further," one of the Rethinking Student Aid group members said. "But we also wanted to propose things that we felt could realistically be accomplished."

Still, should big ideas be automatically eliminated solely based on whether they can be implemented in the next reauthorization?

"If you always do what you've always done, you'll get what you've always gotten," goes the saying. Some of the biggest ideas that could shake up the student aid landscape aren't always the most publicized.

This article looks at five of those ideas—all in different phases of development and implementation—and what it could mean for college access. The first two focus on federal assistance. The final three attempt to work outside the constraints of government assistance.

Student loans are difficult to understand. Most students and parents know they need a loan. What they get are several loans, through several different programs, all with different terms and conditions.

No other consumer product—even a home mortgage—has so many different financing options. Subsidized Stafford loans, unsubsidized Stafford Loans, parent PLUS loans, graduate PLUS loans, Perkins Loans, and private loans (not to mention the differences between the Federal Family Education Loan and Direct Loan programs) all form the extremely complex, $80 billion student loan marketplace.

Financial aid administrators have grown accustomed to this array of options, but college students, parents, and even the media, find the plethora of student loans completely mind boggling.

In 2006, a group of 70 practicing financial aid administrators began meeting to develop a student loan program that would more effectively deliver funds to students and parents. What they came up with was a "one student, one loan" model that included three components:

- One loan program to fund students' entire education costs (cost of attendance minus other financial aid).
- Income-aware repayment so that repayment terms are suitable to students' ability to pay.
- Need-based borrower benefits so that students receive interest discounts and principal reductions solely based on their need during repayment. No borrower benefits—e.g., subsidized loans—would be granted while students are in school.

This model makes sense for students and parents. First, this concept places loan consolidation at the beginning of the loan process, not at the end. It becomes much easier to explain to students a single source of funding as opposed to multiple sources.

Second, borrower benefits are given at the time students need them most, during repayment. With average debt levels hovering around $20,000, the average student will graduate with a monthly loan payment amount of $230. Starting salaries differ by degree, but one thing is for sure: the days where the majority of students use a standard repayment schedule to pay back loans are coming to an end.

Third, students and parents would know that there are funds available to help them meet their entire cost of education. Annual and aggregate loan limits may make sense to legislators worried about federal outlays, but it makes little sense to students and parents who struggle to understand why they have to turn to private student loans because of federal loans caps.

The one student, one loan concept has a few other components, including mandatory financial literacy programs that would begin during secondary school; loan forgiveness programs for borrowers in high-need, low-paying professions; and a mechanism with tax benefits to allow others to repay students' loans.

LIMITATIONS: Critics of this concept point to two big issues with the *One Student, One Loan* group proposal. First, where do all of the current players fit in, if anywhere? The federal government, guarantors, private lenders, banks, state agencies institutions, and other nonprofits all play a diverse role in the marketplace. Historically—before the credit crunch—these different entities competed by offering borrowers benefits. Others, most notably guarantors and state agencies—further public policy goals that focus on financial literacy or increasing loan benefits for specific populations.

The group stresses that the original idea was to put forth a concept first and follow up with details later. Rick Shipman, one of the authors of the group's white paper—"Rethinking Educational Loans"—says they are ironing out details on funding sources and how current entities, such as guaranty agencies and lenders, could still help with default aversion and financing.

The second issue is whether it possible to have one loan for each student or family that can meet all of their higher educational financing needs. That would mean drastic changes in legislation and investment by the government. Still, most aid administrators believe it is the right way to go. In a recent survey conducted by the NASFAA Federal Issues Committee, more than 70 percent of aid administrators said they favored a single student loan program.

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Individual Savings Accounts

Studies show that students and parents from all income levels become more engaged in preparing for college when they have invested some of their own time and money—no matter how little—to the process early on. Michael Sherraden, a professor of social work at Washington University in St. Louis, was one of the first to begin calling for a savings mechanism for low-income families.

Individual savings accounts aren't new. College 529 plans have been around for decades. But while 529 plans have been popular with middle- and upper-income families, they have done little for low-income families who have no incentive or perceived ability to save for college.

Helping low-income families obtain personal savings accounts is what really needs to be addressed. Sherradan claims that asset ownership changes the way people think and can be a more effective anti-poverty plan than welfare or job training benefits. Individual Development Accounts (IDA)—savings accounts that provide matching funds to low income families—came out of Sherradan's idea. The problem is that they're currently underused and underfunded.

The One Student, One Loan group calls for an education account to be established at birth for children, connected to their social security number. Students, parents, or others would be given tax incentives to make deposits into the account. Performing community service or other forms of specific work could allow other entities, like foundations or employers, to also make deposits into the account. Students could use those funds to pay for college, and if there isn't enough money in the account for all college expenses, the account could be allowed to go into the negative.

Instead of actually taking out a loan and repaying a specific entity, students could take out a loan on their personal account that would be paid back over time. Remaining funds could be used for a down payment on a home or for retirement.

The Rethinking Student Aid group calls for a similar concept, but leaves account ownership with the federal government. The One Student, One Loan group proposes a government-created and funded interest-bearing savings account for children whose parents' low income would qualify them to receive Federal Pell Grants. Federal contributions to the savings accounts would be made in proportion to the amount of Pell Grant the students would be eligible to receive. If a family were eligible to receive $5,000 in Pell Grants, the government would deposit a proportion of that into the savings program, for example 10 percent or $500.

Both proposals seek to accomplish Sherradan's goal of changing the way people think by offering families asset ownership.

LIMITATIONS: The concept of informing families early on about the amount of money available to them for college might be more successful in increasing college access than the Pell Grant. The expense of a government-funded savings account means a dramatic increase in funding for federal student aid. The One Student, One Loan group's model doesn't require the government to play such a large role, but still runs the risk of alienating low-income families who might not utilize the funds.

Whether these accounts should be owned by students or by the government would be a major point of contention as well, as demonstrated by the vigorous debate that ensued after President Bush began pushing to privatize—on a limited scale—Social Security accounts.

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Stakeholder Funding Model

Certainly the federal government has a role in promoting higher education access, because a more educated citizenry lifts the standard of living for everyone. Statistically speaking, individuals with a college degree live longer, have healthier lifestyles, are more likely to provide community service, and be more civically minded and involved, according to the College Board's *Education Pays.*

Speaking at an education summit in Washington DC last year, Secretary of Education Margaret Spellings reaffirmed government's role in higher education.

"There's a strong case that strengthening higher education is critical to our future competitiveness," Spellings said. "But in my opinion, there's an even stronger moral case to be made. Helping more Americans earn a degree is not only important for our economic standing...it's essential to reinforcing what our country stands for."

But, that intervention comes at a price. Spellings made that clear when she told college presidents that as the single largest investor in higher education, the government requires much more transparency, reporting, and control over accreditation standards.

"Like any other investment or enterprise, we need meaningful data to better manage and improve the system," Spellings said. "We expect detailed information about nearly every purchase or investment we make, from choosing a doctor to buying a car or home. And in almost every area of our government—from prescription drug programs to welfare to K-12 education—we expect accountability for tax dollars. Yet, when it comes to higher education, we've invested hundreds of billions in taxpayer money and just hoped for the best. Colleges and universities must be more transparent about cost, graduation rates, and learning outcomes, so that students and parents can make more informed choices."

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Some argue that it is still possible to have an effective student aid model without as much government intervention. One such concept being spearheaded by *Greentree Gazette* publisher Jeff Wendt, in development with other business and higher education leaders, seeks to involve all of the stakeholders that benefit from postsecondary education in helping students pay for college.

The three stakeholders that benefit the most—and thus have some responsibility to promote higher education—are: the student, the college, and the employer. Wendt believes there is a workable model that can incorporate all three of these players.

Under Wendt's model, banks would continue to finance loans, although not necessarily through the federal loan programs, and each stakeholder would have some responsibility towards the loan.

- Employers would be responsible for repaying the loan after the student graduates. The amount an employer would pay could be capped, to ensure that employers aren't turning away students based on their debt levels.
- Students would be responsible for purchasing insurance to minimize risk against future loan would default. The insurance premium could be as low as $50 per month—or even lower for schools that serve low-income students—and could possibly diminish the closer a student comes to repayment.
- Schools would be responsible for covering students' interest and insurance premiums while they're in school.

Including employers in the student financial aid is a big departure from conventional financial aid models. But since employers stand to reap the most from a postsecondary harvest, it makes sense to have them more involved.

Employers often complain that it takes anywhere from six months to a year to train college graduates for their actual job. Having employers more involved with higher education could speed up the amount of time it takes college graduates to be a fully functioning employee. As an acknowledged financial stakeholder, employers could conceivably become more involved with curriculum development or in forging stronger internship relationships.

This model provides colleges with a choice. Would you prefer to have the government or private enterprise more involved with your campus?

LIMITATIONS: The model is still in an early conceptual stage and so many of the exact details haven't been addressed. Insurance premium costs to students and schools and employers' willingness to participate given high turnover rates for workers in their 20s must still be worked out.

Whether this model could be implemented at all schools or even a majority of schools also needs to be addressed. For many schools, paying an insurance premium on behalf of students could become a huge burden, especially schools that serve the majority of low-income students. Wendt says that he could conceive of this model working on a trial basis at schools with strong internship programs already in place, for example at the University of Cincinnati or Drexel University.

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P2P Lending

Peer-to-peer (P2P) lending is all the rage. But will it move beyond novelty to a viable, mainstream business model? That question has yet to be answered. One thing is certain, with the recent and dramatic downturn in the credit markets, P2P lending companies are poised to gain at least some market share.

P2P, also dubbed "social lending" or "social finance," gets its roots from a very simple idea: directly connecting borrowers and lenders. This would be analogous to P2P file sharing, where college students would "tap into" other students' computers to share everything from music to pictures to movies.

GreenNote, Prosper, and Lending Club all offer a form of P2P financing, but with different business models. GreenNote allows borrowers to connect with their friends and family to ask for small loans that hopefully add up to one single large loan. GreenNote provides the legally binding verbiage for the loan and handles disbursement and repayment administration. The company boasts a 6.8 percent fixed loan and friends and families are guaranteed (as long as the borrower repays the loan) a small return on their investment plus the good feeling of helping someone they know go to college. GreenNote generates revenue by collecting a one-time documentation fee from students and a management fee from investors.

Prosper and LendingClub offer several types of loans, including education loans. Lending Club attempts to use each borrower's social network as GreenNote does, while Prosper allows lenders to "bid" on loans based on borrowers' needs and credit history. Other social education lending options, like Zopa and Fynanz (both located outside the U.S.), follow similar models with some variations. Fynanz shares the risk of the lenders by offering loan guarantees.

The idea that individuals can lend to other individuals without using a traditional lending institution could revolutionize the way we obtain capital. The closest financial model to social lending comes in the form of credit unions, which have been around for about 100 years. The concepts are similar because credit unions represent "cooperative lending," where individuals with similar vested interests pool their money to lend to other members of the organization with the same interests.

P2P lending takes "cooperative lending" to the next level. The success and stability of credit unions could provide a glimpse into the possible success of P2P lending. Amidst all of the discouraging headlines about a world-wide credit crunch, there is positive news from the nation's credit unions. Credit unions are safe, sound, and continue to make loans because most have been more conservative in their lending practices. Cooperative lending has been more stable than bank lending. Could the same be true of P2P lending?

LIMITATIONS: The idea that individuals can lend directly to individuals at the same levels of efficiency and expertise as established, traditional lending institutions is questionable. But it seems much less questionable after watching the credit markets deteriorate because well-established lending institutions made billions of dollars in bad loans in recent years. The very fact that individuals are lending their own money may make them wiser investors about the type of risk they are willing to take on.

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K-16 Funding

On a national or state level, we may be a long ways from full kindergarten through college funding. It may not even be desirable at a federal level, given the questionable results of public education at the elementary and secondary school levels. But some communities have taken matters into their own hands by providing college funding for their own high school graduates.

The most famous of these comes from Kalamazoo, Michigan, where an anonymous philanthropist has been bankrolling college educations for local area high school graduates since 2005. The program wasn't devised as a college access initiative, but rather an economic initiative to revitalize what was then a fledgling community.

And it's working. Four-hundred families from 88 Michigan communities, 32 states and nine foreign countries have moved into the Kalamazoo school district since the promise began. Those influxes have boosted school enrollment by 12 percent and increased high school graduation rates by 21percent. Local investment levels, employment rates, home prices, and college participation levels have all increased as well.

Other communities have taken notice. Pittsburgh, Denver, and El Dorado, Arkansas have started similar programs. Nearly 82 cities around the country are currently considering similar promise programs. Communities without large philanthropic investors are finding creative ways to boost their own communities. One community—Akron, Ohio—recently voted (albeit unsuccessfully) on privatizing its public sewage facilities to create a local promise program.

The benefits—both for individual students and the community—are big. Most notably, these initiatives are occurring outside of the federal and state programs. Local investment yields local benefits. The programs can be specifically altered to meet the needs of local students and these local scholarship programs, on top of federal and state financial aid, acts as a boon for prospective college students.

The idea that full college funding would come from local communities as opposed to the federal government may seem daunting. But if Kalamazoo has shown one thing, it is that local investment and commitment to higher education may have a much larger impact than national financial aid initiatives alone. Given the success rates at the local level, could federal student aid refocus on local needs as opposed to tackling college access nationally?

LIMITATIONS: It's difficult to imagine a scenario where local college access funding can keep up with the $130 billion federal financial aid programs. Focusing too much on local "promise" scholarships as a solution might also undermine foundational federal student aid programs—like the Pell Grant—that have undisputedly increased college access nationally. But the concept of local financial aid administration could mean an important shift in how we view financial aid.

Ideas Into Reality

Turning conceptual models into realistic programs is difficult. Changes that require alterations thought several layers of bureaucracy are nearly impossible to implement. Still, all change begins with ideas. And while none of these models may solve the college access and persistence problems that plague the nation, they provide vital frameworks to start anew and reexamine our motivations and solutions to help students reach their life goals.

As the new presidential administration takes its place—particularly an administration that ran on a platform of "Change!"—there may be opportunities to reinvent the student aid process rather than to simply tweak the existing programs. In July, NASFAA President & CEO Dr. Phil Day launched the "National Conversation Initiative on Access and Aid for Student Success" (NCI) (http://nasfaa.org/redesign/nci/ncicenter.html). NCI is engaging institutions of higher education, public and private agencies and organizations, elected and appointed officials, students, families, and other individuals in a campaign to increase the numbers of students enrolling and graduating with a college degree, especially low- and moderate-income students, and students who have been historically underrepresented and underserved.

Financial aid administrators from around the country are providing valuable input through town hall meetings and online forums to discuss new ideas on how best to help families afford higher education.

NASFAA, along with a specially appointed advisory board, will be synthesizing all of the information gathered through the initiative and providing a comprehensive set of recommendations to President-elect Obama within his first 100 days.

So, knowing that that hot ideas can cool rather quickly, NASFAA and others in the student aid community are using the opportunity of a new administration to research methods of financial aid reform and strike while the political iron remains hot.

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The NCI campaign is seeking innovative ideas for how to best eliminate the financial barriers to college. Please submit your ideas and recommendations to NASFAA through our forum at www.nasfaapresident.org, or via email at nationalconversation@NASFAA.org.