

National Conversation Initiative Concept Paper for New Student Loan Model

March 17, 2009



New Federal Student Loan Model

Through the National Conversation Initiative, NASFAA has developed a conceptual framework for a new student loan model that combines the most desirable features of today's existing loan programs. This new, integrated loan program would be simpler and more equitable for students while expanding the amount of capital available to make loans through the capital markets. This proposed loan model encourages all beneficiaries of postsecondary education (i.e., borrowers, state governments, private employers, friends and families, and all Americans) to help pay down borrowers' debt levels and raise capital for a self-sustaining loan fund.

Currently, the Federal Perkins Loan Program, the Federal Family Education Loan Program (FFELP), and the Federal Direct Loan Program have different terms, conditions, benefits, and application procedures. This creates unnecessary confusion and complexity for students at the application stage and during repayment, and makes it difficult for students with multiple loans to know exactly what they owe at any given time. Even though borrowers participate in federal loan programs that are subsidized by the government, they are not always treated equally because students may receive different terms and conditions based solely on the school they attend.

This new model integrates the best aspects of each existing loan program into a brand new student loan program. This loan program will not be the Direct Loan Program, the Federal Family Education Loan Program, or the Perkins Loan program, but will retain essential elements of all three:

- Perkins Loans offer borrowers low, fixed interest rates. In addition, Perkins Loan borrowers often find it easier to work with loans that are disbursed through schools.
- The Direct Loan program offers borrowers a single origination and collection agent.
- FFELP loans come with default prevention mechanisms and are funded by private sources, meaning capital for these efforts is not dependent on the federal government.

NASFAA proposes a new student loan program combining the most positive features of each of these programs while reducing complexity and increasing consistency among borrowers.

National Conversation Initiative Concept Paper for New Student Loan Model

March 17, 2009



This new loan program:

- Provides consistent and equal terms, conditions, and benefits to all borrowers
- Offers students a low, fixed interest rate
- Offers students a seamless loan origination, disbursement and repayment experience
- Capitalizes on the unique expertise, best practices, and capacity developed by all entities currently participating in the existing loan programs
- Ensures a predictable and continuous source of capital for student loan funding that is not dependent on any single entity
- Allows individuals, families, companies, financial institutions, and all Americans to express their support for higher education through government-backed special purpose bonds
- Reduces federal expenditures by creating a self-sustaining funding source that relies on a new, safe investment vehicle
- Leverages technological and business innovations in the private sector by creating a common servicing platform that relies on a centralized database of all borrowers and can be used by multiple servicing agents
- Creates new incentives for businesses, individuals, and states to help students repay student loan debt
- Shifts the focus of guarantors to facilitating successful student loan repayment and college access

National Conversation Initiative Concept Paper for New Student Loan Model

March 17, 2009



Raising Capital through Special Purpose Bonds

Money for federal student loans would be raised through a public/private partnership that relies on investment from several different private and public sector sources. As shown at the bottom of Figure 1, these funding sources would include individuals, investment and brokerage houses, banks, insurance companies, mutual funds, pension funds, and even international investors.

The new lending model would leverage investors' ability to raise capital by allowing them to invest in a special purpose government bond that would be used by the U.S. Department of Education to make loans directly to borrowers through schools. Individuals could also purchase these "Education Financing Bonds," a new series of small denomination bonds similar to U.S. savings bonds specifically designated for student loan debt. The bonds would operate much like war, civilian, or patriot bonds introduced previously by the government to raise funds for specific causes. Some governmental – and quasi-governmental agencies – continue to offer special purpose bonds today that are backed by the full faith and credit of the U.S. government.

Proceeds from Education Finance Bonds (EFBs) would fund future federal student loans issued by the U.S. Department of Education. The Department of Education would guaranty these bonds with the full faith and credit of the U.S. government. Like other U.S. bonds, EFBs would have a maturity date, offer investors a modest return on investment over several years, and could be made quite liquid by issuing them on a rolling basis in 1-yr, 3-yr, 5-yr, 10-yr, 15-yr, and 17-yr increments. To incentivize investors, EFBs could offer a slightly

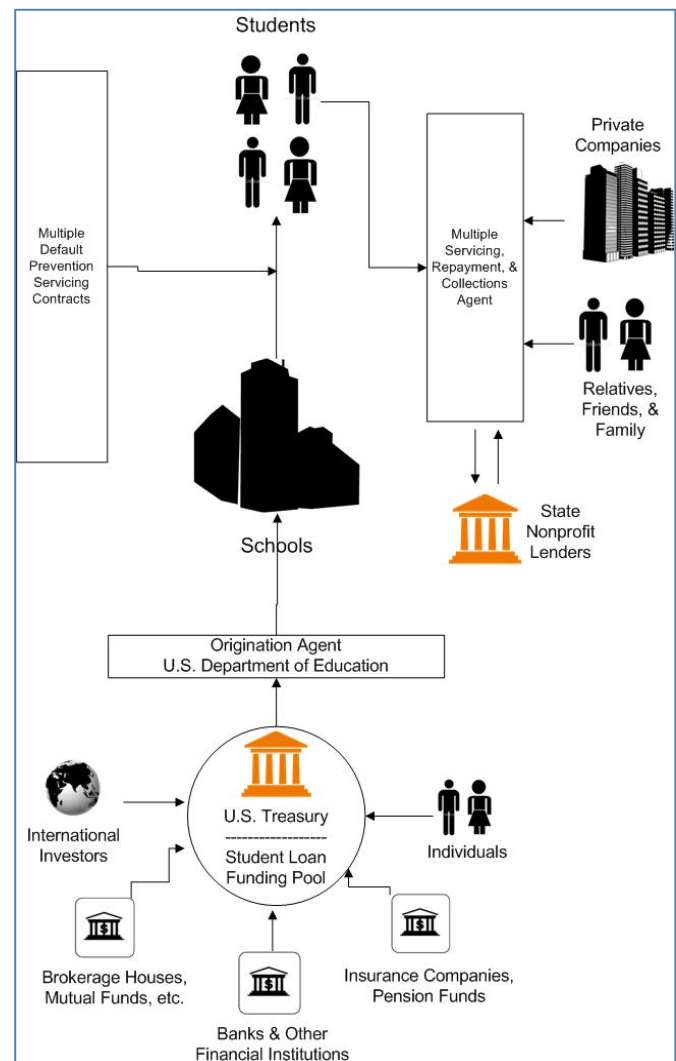


Figure 1 – New Student Loan Model Diagram

National Conversation Initiative Concept Paper for New Student Loan Model

March 17, 2009



higher rate of return than regular government bonds and the yield at issuance could be adjusted to be competitive in the market. Some of the benefits of EFBs to students and taxpayers include:

- **Multiple Funding Sources:** Funding for federal student loans would not be limited to any single source such as banks, schools, or the U.S. government. Various entities could invest in EFBs and help raise enough capital to make the student loan pool viable.
- **Societal Investment in Higher Education:** EFBs offer Americans a way to express their support for higher education and could mobilize individuals, families, friends, companies, and other American financial institutions to invest in higher education in a significant way. Parents and relatives could purchase EFBs to help students save for college. Private companies, pension and mutual fund managers, and other investment firms would find EFBs desirable not only because of their safety and guaranteed return on investment, but also because they support higher education.
- **Reduced Federal Outlays:** Federal student loans would continue to be assets of the federal government, but could eventually become self-sustaining and wouldn't be subject to the budget process.

The U.S. Department of Education would serve as a back-up funding source for any shortfalls in the EFB market.

Common Origination and Disbursement

Under a new student loan model, all student loan origination would be handled by a servicer contracted by the U.S. Department of Education. Current proprietary servicing mechanisms would be leveraged by the Department through a competitive bidding process. Loans would be disbursed to borrowers through schools and applied directly to students' accounts.

All new borrowers would fill out a Master Promissory Note that would be held by the U.S. Department of Education and all borrowers would be given the same terms, conditions, and benefits no matter what type of institution they attend. Students would not be required to choose a lender or sort through preferred lender lists.

National Conversation Initiative Concept Paper for New Student Loan Model

March 17, 2009



Repayment and Default Prevention

The U.S. Department of Education would contract with multiple servicers to process borrower payments and handle deferments, forbearances, and loan forgiveness. Allowing multiple servicing contracts is an important way to leverage competition that will benefit borrowers. Servicers would be selected through a competitive bidding process that focuses not only on price, but also on past performance, stability and longevity in the marketplace, an adequate technological infrastructure, and a set of other predetermined operational standards defined with input from students and schools.

No matter the servicer, the process must be completely seamless for borrowers. All competition would happen among servicers that bid through the U.S. Department of Education. All servicers would rely on a common servicing platform built around a centralized database of all borrowers. Whether the servicers simply share a request queue or divide the borrowers into predetermined segments is less important than the idea that borrowers would have a single name and contact to reach out to for assistance with their loan. Borrowers would never know or care which servicer is handling their specific loan.

In addition, the Department would contract with these servicers or other default prevention servicers to ensure that borrowers remain in good standing and to help with campus-wide default prevention efforts, including entrance and exit counseling. Compensation to entities that provide these services would be tied to default success rates calculated over multiple years.

Involving Additional Stakeholders in Repayment

While students are certainly the main beneficiaries, states and businesses also reap the benefits that postsecondary education provides. As such, these entities also have a part to play in reducing student loan indebtedness.

State agencies, which have traditionally offered generous borrower benefits under stated public policy positions (e.g., increasing the number of nurses, teachers, or engineers), could participate in the new student loan model in two ways: They could pay off a portion of a student's loan, or they could purchase a student's loan outright and assume liability for the loan, which would allow them to offer borrowers increased benefits above and beyond the terms and conditions already associated with the federal loan.

National Conversation Initiative Concept Paper for New Student Loan Model

March 17, 2009



In addition, a “Human Capital Tax Credit” would spur private companies to begin offering generous loan repayment benefits to employees. Allowing companies to pay off student loan debt leverages federal tax benefits to encourage private businesses to help borrowers meet their student debt obligations. Much like other human resources incentive and recruitment programs, the Human Capital Tax Credit could become a standard part of a company’s benefits package. Union contracts and other non-profit organizations should also receive a government credit or incentive to offer repayment benefits to borrowers.

Friends, family, and other relatives who help pay off a borrower’s accumulated loan debt should likewise receive tax benefits and under no circumstances should borrowers be penalized by taxes for receiving any loan repayment or forgiveness benefits.

Participants in the New Student Loan Model

- **Borrowers** will receive loan funds through their school and repay their loans to the U.S. Department of Education through contracted servicers. Changes in servicing contracts awarded by the Department of Education will not be visible to borrowers.
- **Schools** will certify loan amounts, receive funds from the Department, and apply them to students’ accounts. Schools will also coordinate with default prevention servicers to ensure borrowers receive appropriate loan counseling.
- **Private Sector Investors** (including banks) will no longer directly market federal student loans to schools or to students. They will also not be responsible for collecting federal loans. Instead, investors from different sectors of the financial markets, as well as individuals, will help raise capital for federal student loans.
- **U.S. Department of Education** will be responsible for leveraging private technological and servicing innovations through competitive bidding contracts for common loan origination and disbursement. The Department will also be responsible for choosing servicers to handle repayment and default prevention. The Department will oversee the student loan program and ensure servicers are meeting all contract obligations on behalf of borrowers.

National Conversation Initiative Concept Paper for New Student Loan Model

March 17, 2009



- **Servicing:** Servicing contracts will be awarded through a competitive bidding process that focuses on more than just price. Other factors to be used in awarding servicing contracts will be determined with input from students and schools.
 - **Private companies** will have the opportunity to bid on servicing contracts issued by the Department. Servicers will not market to students on their own behalf or on behalf of any lender. Servicers will act solely on behalf of the U.S. Department of Education. To borrowers, it will appear that they are repaying the Department of Education.
 - **Guarantors or Other Nonprofit Agencies** that already have the infrastructure to offer default prevention services will bid for servicing contracts. They may also assume responsibilities for college access and outreach work. These agencies will not guarantee federal student loans and will be compensated based on the number of borrowers they keep out of default.
- **Families, Friends, and Relatives** can contribute to funding the student loan programs by purchasing Education Financing Bonds or by paying off a portion of a student's loan with an associated tax benefit.
- **Private Companies** will receive a Human Capital Tax credit for paying off any portion of a student's loan debt.
- **State, Nonprofit Lenders** may offer borrowers additional benefits under specified circumstances. State nonprofit lenders may pay off a portion of a borrower's loan, or purchase a borrower's loan outright and assume liability for the loan for the express purpose of focusing on priority high-need employment areas (e.g., teachers, nurses, public defenders, police and fire).

About the National Conversation Initiative

The conceptual framework for this new student loan model is based on members' recommendations given as part of NASFAA's National Conversation Initiative (NCI) as well as the counsel of public policy experts and data collected from more than 40 related research studies. This model is just one part of a much larger, preliminary proposal that will be released in March 2009 to completely reform the student aid system. Learn more about NCI at www.nasfaa.org.