



Testimony of

Robert Shireman
Executive Director, Project on Student Debt

Before the U.S. Department of Education, Office of Postsecondary Education

in response to the

Notice of Negotiated Rulemaking for Programs
Authorized Under Title IV of the Higher Education Act of 1965, as Amended

September 19, 2006
Berkeley, California

My name is Robert Shireman, and I serve as the executive director of the Project on Student Debt, an initiative of The Institute for College Access and Success (TICAS), Inc., a nonpartisan, not-for-profit policy research organization. The goal of the Project is to identify cost-effective policies that expand educational opportunity, protect family financial security, and advance economic competitiveness.

The notice published in the Federal Register on August 18 asked for public comment regarding actions that the Department of Education could take through the regulatory process. I am pleased to offer some recommendations. But first I would like to make note of two statutory items that require attention from the Administration and Congress. First and foremost is the need for a substantial increase in the Federal Pell Grant, an idea strongly endorsed by the Secretary's Commission on the Future of Higher Education

in its final draft report. I urge the Department to make increasing the Pell Grant a priority in the upcoming FY 2008 President's Budget. A second important statutory change is in the need analysis formula. As currently designed, dependent students' earnings are taxed excessively, especially in situations where they are helping to support an already low-income family. While Congress must approve any major change in need analysis, leadership from the Administration could make that happen.

One area where the Department of Education has clear authority to regulate is in defining the terms and conditions for student loan deferral, forbearance, and other repayment options and assistance. The two primary areas that we are recommending be changed are the rules for "economic hardship" and "income-contingent repayment." The Secretary's authority to address those provisions by regulation is unquestionable. On economic hardship, the statute reads as follows:

*[A] borrower shall be considered to have an economic hardship if . . . such borrower meets such other criteria as are **established by the Secretary** by regulation. . .*

[T]he Secretary shall consider the borrower's income and debt-to-income ratio as primary factors.

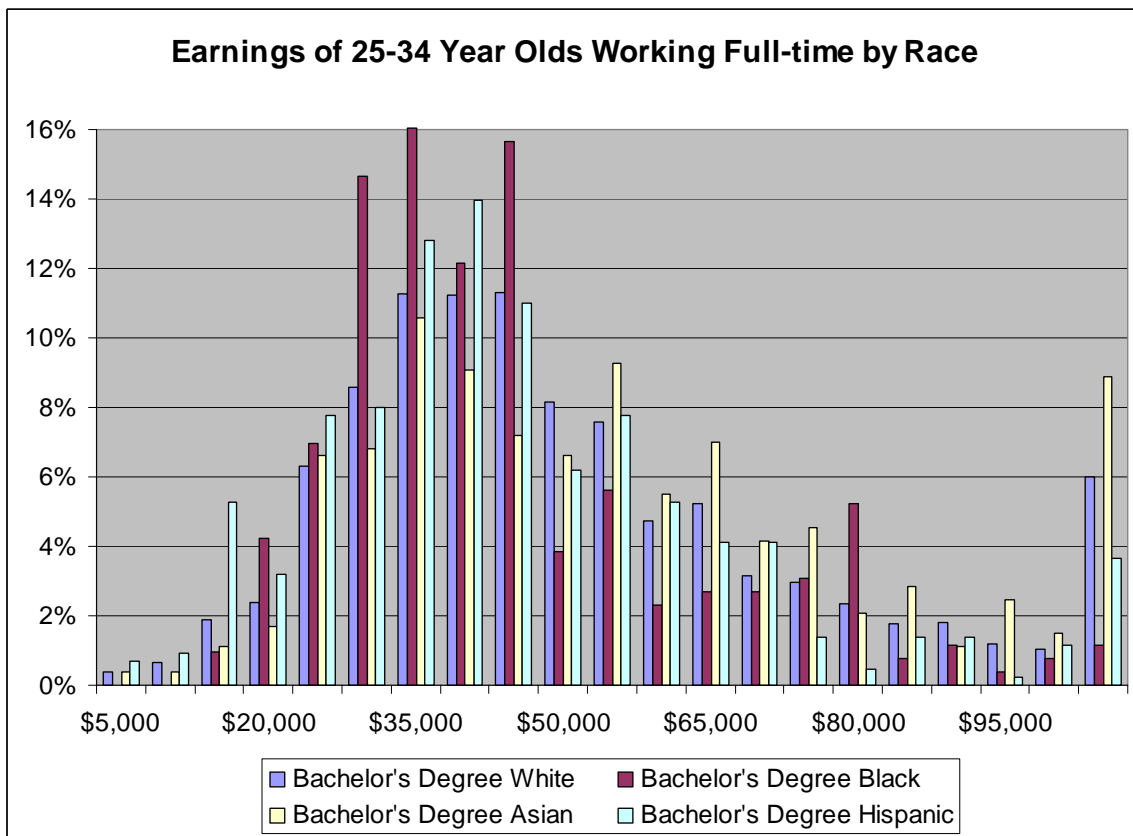
With regard to income-contingent repayment, Congress left the details to the Secretary:

*Consistent with **criteria established by the Secretary**, the Secretary shall offer a borrower of a loan made under this part. . . an income contingent repayment plan, with varying annual repayment amounts based on the income of the borrower, paid over an extended period of time **prescribed by the Secretary**, not to exceed 25 years. . .*

We are asking that you use that authority that has been so clearly given to you by Congress. I will take a few minutes to delineate some of the problems with the current

rules, and then describe the proposals we recommend be included in the negotiated rulemaking.

The rationale for taking out a student loan to pay for college is that it is an investment: the average earnings of someone with a college degree are higher than the average earnings of someone with only a high school diploma. But economists have long pointed out that “[t]he average expected return may be high, but there is wide variation about the average.”¹ This histogram shows the distribution of annual incomes for college graduates (four-year degrees) working full-time, age 25-34:²



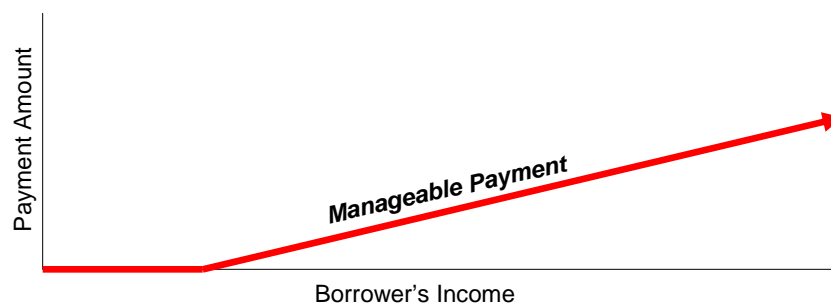
¹ Milton Friedman, “The Role of Government in Education,” in Robert A. Solo, ed., *Economics and the Public Interest*, Rutgers University Press, 1955.

² U.S. Census Bureau, Current Population Survey, 2005 Supplement. Computations by the Project on Student Debt.

Overall, higher education is a good investment for individuals, our society, and our economy. But for the individual who cannot know where he or she will land on the earnings spectrum, the investment is risky, not unlike investing in stock in a company (an investment that most people do not feel comfortable making with borrowed funds). That is why any student loan system designed to encourage participation in higher education must include some relief when borrowers find themselves on the low end of that income distribution.

The student loan programs in the United States *do* include provisions intended to protect borrowers from burdensome and unreasonable payment requirements. The problem is that the protections do not work very well—that is why they need attention in this negotiated rulemaking. The main deficiencies include: (1) inconsistent and inadequate coverage of payment relief; (2) perverse incentives; and (3) confusion and inequity.

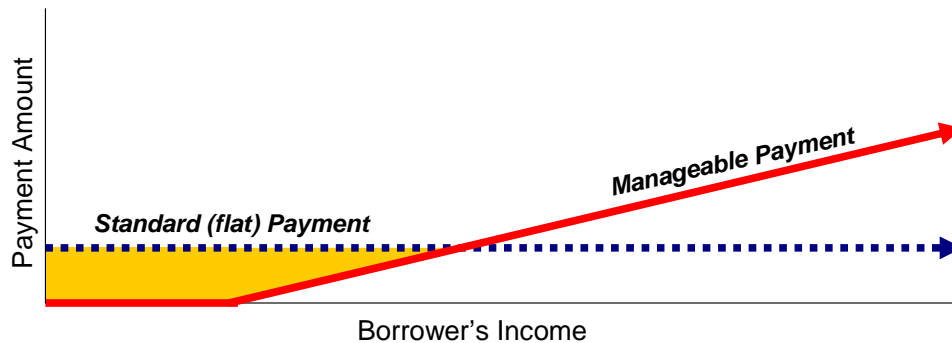
Coverage gaps. To illustrate the deficiencies, I'm going to start with a graph that will show the level of payments that are on the borderline of manageable. This is based on the recent research by two economists, Sandy Baum and Saul Schwartz.³ But it will make sense to non-economists, too.



³ Sandy Baum and Saul Schwartz, *How Much Debt Is Too Much? Defining Benchmarks for Manageable Student Debt*, The College Board and the Project on Student Debt, 2006.

At the lowest income levels, a borrower is not in a position to make anything more than a token payment, represented by the horizontal portion of the red “Manageable Payment” line. That line turns upward as the borrower’s income rises, because she can begin to set aside a portion⁴ for payments on student loans.

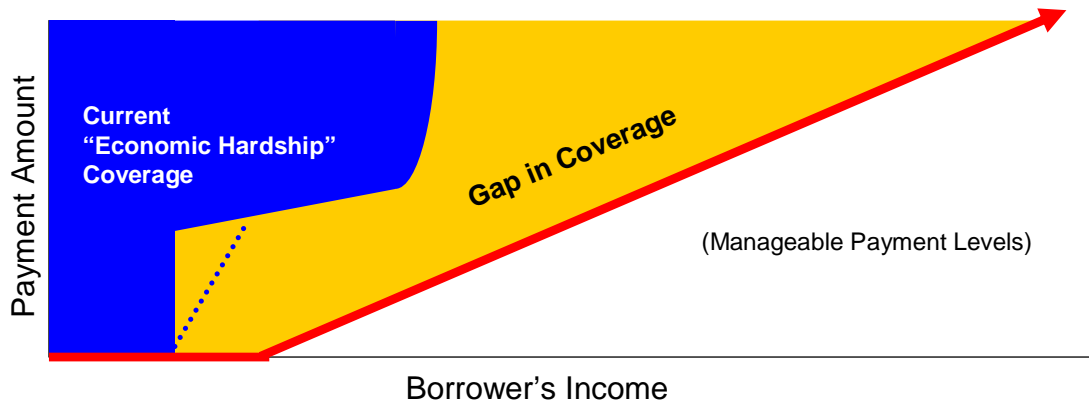
Standard payments on student loans are unrelated to income, and are generally set so that the borrower can make the same monthly payment and finish repaying the loan in a certain time period: the standard is 10 years. The monthly payment level is represented on the graph below by the dotted line. The shaded area represents payments, or portions of payments, that it would be *unreasonable* to expect borrowers to be able to afford given their income.



The goal of the repayment system in a government loan program is to ensure that borrowers make payments whenever it is reasonable to expect that they can. The vast majority of borrowers meet this criterion, most of the time. But when borrowers face genuine economic hardship (the shaded area at the left side of the above graph), it is appropriate for a loan program to ensure that payment requirements *remain* reasonable. To what extent does the current federal program do this? If we zoom in and take a closer look

⁴ How much, and at what income level, are discussed later.

at the shaded area, we can map the situations for which the current “economic hardship” deferment rules provide relief. They are shown in blue in the graph below. They are oddly shaped because they are oddly written. While an important subset of struggling borrowers is eligible for economic hardship relief, many who are in similar need do not make the cut.



Not shown in the graph is the fact that the current hardship rules are the least helpful to borrowers who face the greatest demand for their limited resources: those with children. A single borrower with an income of \$30,000 is certainly in a much better position to make payments on her loan than a mother of two children with the same income. Yet the hardship rules treat the two situations exactly the same way. In addition to filling in the gaps in coverage, revised hardship rules should take family size into consideration in defining reasonable payment levels.

Perverse incentives. Some of the current repayment policies, because of the way they are designed, can actually have the opposite effect from what we would want out of good public policy. This is particularly true of the all-or-nothing interest relief under current economic hardship rules. For example, a pre-school teacher with \$25,000 in student loans, making \$17,500, would normally be happy to be offered a 10 percent raise. However, with

that raise he would lose eligibility for interest relief and be slightly *worse* off. The same is true for a medical resident earning \$39,000 with student loan debt of \$75,000.⁵

How a Pre-School Teacher Could be Worse Off with a Raise

	Student Loans: \$25,000	
	Before	After
	10%	10%
	Raise	Raise
Annual Income:	\$17,500	\$19,250
Student Loan Interest Relief:	\$1,785	not eligible
Net Income	\$19,285	\$19,250

How a Medical Resident Could be Worse Off with a Raise

	Student Loans: \$75,000	
	Before	After
	10%	10%
	Raise	Raise
Annual Income:	\$39,000	\$42,900
Student Loan Interest Relief:	\$5,335	not eligible
Net Income	\$44,335	\$42,900

The current economic hardship rules also have different and in some cases more generous eligibility criteria for those who are working part time than for those who are working full time. The way they are designed, there are situations when it would be in a low-income borrower's financial interest to work *less*.

The improved economic hardship rules that we are recommending would provide appropriate relief to borrowers, but would improve upon the current rules by ensuring that borrowers have a financial incentive to earn more if they can.

⁵ These examples assume the current 7.14% interest rate on variable-rate loans made prior to July 1, 2006, and they assume the loans are all subsidized (which means that the government pays all of the interest during economic hardship status, for up to three years).

Confusion and inequity. So far, in my discussion of economic hardship rules, I have presumed that the borrower is actually able to figure out whether and under what circumstances she would qualify for relief. As it turns out, that is *not* a reasonable assumption. The rules are bizarre and illogical, and the borrower is unlikely to be made aware of them in the first place. The route most likely to be offered to a struggling borrower when she contacts her lender is “forbearance,” which allows her to put off payments without going into default. This cessation of payments may be useful, but it is also costly, with interest charges piling quickly onto an already unmanageable loan. We are told that in many cases borrowers who might be able to take advantage of interest relief through the economic hardship deferment are not informed of the option. It is understandable: forbearance is an easy process for the lender and the borrower, while economic hardship—which is substantially better ultimately for qualifying borrowers—involves no less than seven pages of forms and worksheets (see attached).

Another option that borrowers have—if they are told about it—is income-contingent repayment (ICR).⁶ For borrowers who are going to be struggling for many years, it might be best to be in ICR, to be able to make use of forgiveness after 25 years. But most do not know whether and when their economic situation will improve. The down side of ICR—other than depressing level of pessimism required—is that interest charges continue to build up, even for those borrowers who would have gotten interest relief under economic hardship. So if the outlook is less grim, it might be better to take an economic hardship deferment.

⁶ ICR is only available in the Direct Loan Program, which serves about 25 percent of students. Borrowers in the guarantee program known as the FFEL (Federal Family Education Loan) Program are able to consolidate their loans into the Direct Loan Program in order to access ICR.

This is not easy to figure out. For many, it's impossible.

The goal of our suggested regulatory improvements is to end the guessing game for borrowers who are struggling, without foreclosing their options. Whether they have a FFEL loan or a Direct loan, borrowers facing heavy repayment burdens could take advantage of interest relief under economic hardship, and would also maintain their eligibility for ultimate forgiveness, if they end up in the unfortunate circumstance of a long-term, high-debt, low-income situation.

Recommendations for Negotiated Rulemaking

Fortunately, the Department of Education can go a long way toward addressing these problems by taking up these issues of coverage, consistency, clarity and equity in the upcoming rulemaking. We urge you to adopt the five-point plan for fair loan payments that we developed along with student organizations, the lending industry, parent and family advocacy groups, and others concerned about the effects of rising student debt on educational opportunity, economic security, and family life. The specific language for the recommended changes in regulations is in the administrative petition we submitted in May, and is included in the testimony of Jamiene Studley being presented today. The changes aim to accomplish the following:

1. **Limit student loan payments to a reasonable percentage of income.** When borrowers are earning less than 150% of the poverty level they would be required to make no more than token payments. Above that level of income, required payments could not exceed 15% of each additional dollar earned. Under this approach, the

- majority of graduates would see their loan payments capped at less than 10% of their income; the limit for graduates with higher incomes would never exceed 15%.
2. **Recognize that borrowers with children have less income available for student loan payments.** Under the coalition recommendation, until the borrower is earning at least 150% of the poverty level *adjusted for family size*, they would be required to make no more than token payments. This means that at any given income level, the maximum manageable payment is less for a family than for a single individual.
 3. **Protect more borrowers from high interest charges when they face hardship situations.** When borrowers' debt burdens qualify them for relief under the terms recommended by the coalition, interest on subsidized Stafford or Perkins loans would not accrue as long as the borrower stays current with the affordable (capped) payment amount.
 4. **Cancel remaining debts when borrowers have made regular payments for 20 years.** In order to be eligible for forgiveness, borrowers must have made payments for 20 years. Qualifying payments include both those that fit a standard 10-year flat amortization schedule *and* lower payments due to economic hardship. (Borrowers who *chose* to stretch out their loan payments but did not face hardship would not be able to count those payments toward the potential forgiveness.)
 5. **Simplify the application process for hardship deferrals and other repayment options.** Borrowers should be able to file for relief electronically, and should have the option of authorizing the lender to confirm their income through the IRS.

In its draft final report, the Commission on the Future of Higher Education identified “decreased debt burden” as one of four fundamental principles that should guide our financial aid system. According to the draft, “too many students are either discouraged from attending college by rising costs, or take on worrisome debt burdens in order to do so.” The Department of Education has the power to act. Through the rulemaking process, you can improve access and opportunity for those who must borrow to get the education that they, our society, and our economy need to compete and succeed.

Thank you for this opportunity to provide input into this negotiated rulemaking process. Please do not hesitate to contact me if you have any questions regarding our recommendations or my testimony.

ECONOMIC HARDSHIP DEFERMENT WORKSHEET A

Use this worksheet to determine if you are eligible for an economic hardship deferment based on condition (5) in Section 2 of the Economic Hardship Deferment Request form.

DO NOT RETURN THIS WORKSHEET WITH THE DEFERMENT REQUEST—KEEP IT FOR YOUR RECORDS

STEP 1

Are you working full-time?
Yes You do not qualify for an economic hardship deferment based on condition (5). Do not continue with this worksheet. Refer to Worksheet B.
No Go to Step 2.

STEP 2

(1) Line 1. Enter the amount listed below for your state:
(2) Line 2. \$ 1,785.32
(3) Line 3. Enter the larger of Line 1 or Line 2:
(4) Line 4. Enter your MONTHLY INCOME:

(5) Is the amount on Line 4 larger than the amount on Line 3?
Yes You do not qualify for an economic hardship deferment based on condition 5. Do not continue with this worksheet.
No Go to Step 3.

Amounts for Line 1, above:
\$2,200.00 (if you live in any of the 48 contiguous states or the District of Columbia) \$2,750.00 (if you live in Alaska) \$2,530.00 (if you live in Hawaii).
NOTE: If you are not currently living in the United States, use the amount for your last state of residence in the United States.

STEP 3

LOANS WITH A REPAYMENT PERIOD OF 10 YEARS OR LESS (See definition of "repayment period" in Section 5 of the deferment request form.)
Determine the total scheduled monthly payment of all your loans that are now in repayment for a period of 10 years or less (including the loans for which you are now requesting deferment).

Table with columns: Loan Type, Actual Scheduled Monthly Payment. Lists various loan types like Federal Stafford Loans, Direct Subsidized and Direct Unsubsidized Loans, etc.

STEP 4

LOANS WITH A REPAYMENT PERIOD OF MORE THAN 10 YEARS (See definition of "repayment period" in Section 5 of the deferment request form.)
(A) Determine the total amount you owed when your loans entered repayment by adding together the amounts owed for the federal education loans listed below that are now in repayment for a period of more than 10 years (including the loans for which you are requesting deferment).

Table with columns: Loan Type, Total Amount You Owed When Your Loans Entered Repayment. Lists various loan types and their corresponding owed amounts.

ECONOMIC HARDSHIP DEFERMENT WORKSHEET A (Continued)

(B) Circle the current interest rate for your FFEL Program loan(s) in the chart below. If your exact interest rate is not listed, choose the next highest interest rate. If you have loans with different interest rates, circle the rate for the loan with the highest interest rate.

Interest Rate chart with columns for interest rates (4.0% to 9.0%) and rows for Constant Multiplier and Interest Rate.

(C) Multiply the TOTAL AMOUNT OWED from (A) by the constant multiplier listed directly below the interest rate that you circled in the chart above:

Formula: TOTAL AMOUNT OWED (from A) x Constant Multiplier (from B) = ESTIMATED MONTHLY PAYMENT*

*This is an estimate of the amount that you would pay each month on these federal education loans if they were scheduled to be repaid in fixed installments over a 10-year period.

STEP 5

Add the TOTAL ACTUAL MONTHLY PAYMENT from Step 3 with the TOTAL ESTIMATED MONTHLY PAYMENT from Step 4 to determine your COMBINED TOTAL MONTHLY PAYMENT AMOUNT.

Formula: TOTAL ACTUAL MONTHLY PAYMENT (from Step 3) + ESTIMATED MONTHLY PAYMENT (from Step 4) = COMBINED TOTAL MONTHLY PAYMENT AMOUNT

STEP 6

(1) Line 1. Enter your MONTHLY INCOME (from Step 2):
(2) Line 2. Enter your COMBINED TOTAL MONTHLY PAYMENT AMOUNT (from Step 5):
(3) Line 3. Subtract Line 2 from Line 1:
(4) Line 4. Enter the amount listed below for your state:
(5) Line 5. \$ 892.66
(6) Line 6. Enter the larger of Line 4 or Line 5:
(7) Line 7. Enter the amount from Line 3:

(8) Is the amount on Line 7 larger than the amount on Line 6?
Yes You do not qualify for an economic hardship deferment based on condition (5).
No You meet the qualifications for an economic hardship deferment based on condition (5). Check the box for condition (5) in Section 2 of the deferment request.

Amounts for Line 4, above:

\$1,100.00 (if you live in any of the 48 contiguous states or the District of Columbia)
\$1,375.00 (if you live in Alaska)
\$1,265.00 (if you live in Hawaii)

NOTE: If you are not currently living in the United States, use the amount for your last state of residence in the United States.

ECONOMIC HARDSHIP DEFERMENT WORKSHEET B

Use this worksheet to determine if you are eligible for an economic hardship deferment based on condition (6) in Section 2 of the Economic Hardship Deferment Request form.

DO NOT RETURN THIS WORKSHEET WITH THE DEFERMENT REQUEST—KEEP IT FOR YOUR RECORDS

STEP 1

Are you working full-time?
Yes Go to Step 2.
No You do not qualify for an economic hardship deferment based on condition (6). Do not continue with this worksheet. Refer to Worksheet A.

STEP 2

LOANS WITH A REPAYMENT PERIOD OF 10 YEARS OR LESS (See definition of "repayment period" in Section 5 of the deferment request form.)
Determine the total scheduled monthly payment of all your loans that are now in repayment for a period of 10 years or less (including the loans for which you are requesting deferment).

Table with columns: Loan Type, Actual Scheduled Monthly Payment. Lists various loan types and their corresponding monthly payments.

STEP 3

LOANS WITH A REPAYMENT PERIOD OF MORE THAN 10 YEARS (See definition of "repayment period" in Section 5 of the deferment request form.)
(A) Determine the total amount you owed when your loans entered repayment by adding together the amounts owed for the federal education loans listed below that are now in repayment for a period of more than 10 years (including the loans for which you are requesting deferment).

Table with columns: Loan Type, Total Amount You Owed When Your Loans Entered Repayment. Lists various loan types and their corresponding owed amounts.

ECONOMIC HARDSHIP DEFERMENT WORKSHEET B (Continued)

(B) Circle the current interest rate for your FFEL Program loan(s) in the chart below. If your exact interest rate is not listed, choose the next highest interest rate. If you have loans with different interest rates, circle the rate for the loan with the highest interest rate.

Interest Rate chart with columns for interest rates (4.0% to 9.0%) and rows for Constant Multiplier and Interest Rate.

(C) Multiply the TOTAL AMOUNT OWED from (A) by the constant multiplier listed directly below the interest rate that you circled in the chart above:

Formula: TOTAL AMOUNT OWED (from A) x Constant Multiplier (from the chart above) = ESTIMATED MONTHLY PAYMENT*

*This is an estimate of the amount that you would pay each month on these federal education loans if they were scheduled to be repaid in fixed installments over a 10-year period.

STEP 4

Add the TOTAL ACTUAL MONTHLY PAYMENT from Step 2 with the TOTAL ESTIMATED MONTHLY PAYMENT from Step 3 to determine your COMBINED TOTAL MONTHLY PAYMENT AMOUNT.

Formula: TOTAL ACTUAL MONTHLY PAYMENT (from Step 2) + ESTIMATED MONTHLY PAYMENT (from Step 3) = COMBINED TOTAL MONTHLY PAYMENT AMOUNT

STEP 5

(1) Line 1. Enter your monthly income:
(see the definition of "Monthly income" in Section 5 of the Economic Hardship Deferment Request)

(2) Line 2. Multiply the amount on Line 1 by .20 (-20%):

(3) Line 3. Enter your COMBINED TOTAL MONTHLY PAYMENT AMOUNT (from Step 4):

(4) Is the amount on Line 3 equal to or larger than the amount on Line 2?
Yes Go to Step 6.
No You do not qualify for an economic hardship deferment based on condition (6). Do not continue with this worksheet.

STEP 6

(1) Line 1. Enter your monthly income:
(2) Line 2. Enter your COMBINED TOTAL MONTHLY PAYMENT AMOUNT (from Step 4):

(3) Line 3. Subtract Line 2 from Line 1:

(4) Line 4. Enter the amount listed below for your state:

(5) Line 5. \$ 1,963.85

(6) Line 6. Enter the larger of Line 4 or Line 5:

(7) Line 7. Enter the amount from Line 3:

(8) Is the amount on Line 7 less than the amount on Line 6?

Yes You meet the qualifications for an economic hardship deferment based on condition (6). Check the box for condition (6) in Section 2 of the deferment request.
No You do not qualify for an economic hardship deferment based on condition (6).

Amounts for Line 4, above:

\$2,420.00 (if you live in any of the 48 contiguous states or the District of Columbia)
\$3,025.00 (if you live in Alaska)
\$2,783.00 (if you live in Hawaii)

NOTE: If you are not currently living in the United States, use the amount for your last state of residence in the United States.