Position Paper

Recommendations for the
2003 Reauthorization of the Higher Education Act of 1965

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INTRODUCTION

The primary purpose of federal involvement in higher education is to help prepare students for the rigors of college, to encourage qualified students to pursue a higher education, and to remove barriers to access and persistence.

Barriers to educational opportunity come in many forms, ranging from inadequate student preparation to an actual or perceived inability to afford the cost of a college education. Any attempt to improve access to postsecondary education must address each stage of the pipeline. One cannot sacrifice early intervention programs, such as GEAR UP and TRIO, for financial assistance programs, such as the Pell Grant, or vice versa. Nevertheless, the most significant factor causing students to fail to aspire to college, to fail to apply for college admission, and to fail to ultimately graduate is money.

Accordingly, the focus of the following recommendations for the 2003 Reauthorization of the Higher Education Act of 1965 is on Title IV (Student Assistance).

SIMPLIFICATION

A primary goal of this reauthorization should be to simplify and streamline the financial aid process. This is not just to reduce the regulatory burden on colleges and to reduce government costs, but also because the complexity of the financial aid process is itself a barrier to access. Most families find the elaborate and convoluted collection of financial aid programs, forms and procedures to be intimidating and confusing. Financial aid lacks transparency and the steps needed to obtain necessary aid are too complicated, making it hard for students and parents to determine whether they will be able to afford a college education. As a result, most low-income students and their families believe that a college education is not an attainable goal.

Consider, for example, the complexities inherent in one program, student loan consolidation. Starting July 1, 2002, the interest rate on Stafford Loans dropped to 4.06%, except for loans issued from July 1994 through June 1998, which now have an interest rate of 4.86%. However, if the student is in the in-school period or grace period, the rate is 3.46%, except for loans issued before July 1998, which have a rate of 4.86%. (Don't even ask about loans issued before July 1994.) Students with loans in the FDSL program can consolidate during the in-school period to lock in those loans at a rate of 3.5%; students with loans in the FFEL program have to wait until they graduate, to lock in at 3.5% if they consolidate during the grace period and 4.13% during the repayment period, unless they happen to have at least one loan in the FDSL program, in which case they can consolidate during the in-school period. Students who have all their loans in the FFEL program can consolidate after they graduate, but have to use the current holder of their loans (which might not be the same as their originating lender, if that lender sold their loan on the secondary market), unless they have loans with more than one lender, in which case they can choose any lender. Also, even if the student's loans are with a single lender, if that lender does not offer the student a consolidation loan or a consolidation loan with income sensitive repayment, they can consolidate with a different lender that offers the repayment provision. If the student previously consolidated some loans, they can include the previous consolidation loan in a new consolidation, provided they have at least one unconsolidated loan, but they don't get to relock the interest rate on the old consolidation loan. If the student has multiple loans at different interest rates, the consolidation loan's interest rate is the weighted average of the component loans rounded up to the nearest 1/8th of a point. Normally this would mean that a student who is consolidating to lock in a low rate wouldn't want to include the fixed rate Perkins Loans in the consolidation loan, because of the potential for a 1/8th of a point interest rate penalty. However, since most servicers of Perkins loans do not offer a 0.25% interest rate reduction for EFT payments, and most lenders who offer consolidation loans do, a student who elects for EFT payments can gain a 1/8 to 1/4 of a point advantage by including Perkins loans in the consolidation loan. However, students who consolidate the Perkins loan lose access to certain forgiveness provisions of the Perkins loan that aren't available to students with Stafford loans and consolidation loans. Note that Perkins loans that are consolidated under FDSL are considered subsidized loans which is not the case under FFELP consolidations.
Is it any wonder that even financial aid professionals and lenders themselves are often confused by the complexities of consolidation loans? The reality of student loan consolidation is even more complicated than the outline summarized in the previous paragraph.

Every aspect of every federal student aid program is much too complicated. One needs a college degree in mathematics just to understand how the different programs interact and to assess the potential impact of the different choices available to families.

Unfortunately, when Congress increases funding for higher education, it often involves establishing new programs instead of increasing funding for existing programs, further complicating the process. For example, the Taxpayer Relief Act of 1997 established new student aid programs through the internal revenue code. It created the Hope Scholarship for the first two years of the student's undergraduate education, and the Lifetime Learning program for all other years of higher education, but the two programs have different criteria. In addition, parents now have to choose from three different savings vehicles: Coverdell Education Savings Accounts, state prepaid tuition plans, and section 529 college savings plans. If the decisions weren’t already complicated enough, there’s also the Alternative Minimum Tax (AMT) to consider.

Although additional funding for higher education is encouraging, it would have an even greater impact if the funding were provided in a manner that made it easier for families to predict their out-of-pocket cost for a college education.

To fix the highly reticulated structure of federal student aid programs, Congress should merge similar programs, make the rules more uniform and universal across all programs, and streamline complicated rules that focus on micro-managing the programs. The current patchwork of rules and regulations makes student aid very difficult for students and parents to understand.

For example, here are a handful of recommendations for simplifying federal student aid programs. Reauthorization offers the opportunity for a comprehensive review.

1. Eliminate the Perkins Loan Program, merging it into the Stafford Loan Program. In particular:
   a. The loan forgiveness and deferment provisions of the Stafford loan and the Consolidation Loan should be amended to include the additional loan forgiveness provisions available to the Perkins Loan. All federal education loans should be subject to the same rules for forgiveness, deferment, forbearance and discharge.
   b. Modify the Stafford Loan to include increased subsidized loan amounts for low-income students, to compensate for the elimination of the Perkins Loan.
   c. Increase the annual and cumulative loan limits for the Stafford Loan. (See below for more details.)

Existing Perkins fund balances could be addressed in many ways. One method would be for the US Department of Education to assume responsibility for the administration and servicing of existing Perkins loans, with amounts repaid by borrowers being rolled into the Pell program. Another possibility would be to allow colleges to use the borrower payments as a supplemental grant for Pell Grant recipients until the funds are exhausted.

The main arguments against eliminating the Perkins Loan program are the packaging flexibility is provides, as well as the better forgiveness provisions. But the Perkins loan does not currently function well as a supplement or complement to the other federal education loan programs, and any attempt to fix the shortcomings of the program will be inadequate. The annual appropriations for the Perkins program can be more effectively spent through other student financial aid programs. Note, however, that the Perkins Loan should only be eliminated if the Stafford Loan limits are increased enough to compensate and the forgiveness provisions are improved to include all of the Perkins Loan forgiveness provisions.

2. Modify the interest rate calculation for Consolidation Loans, eliminating the "round up to the nearest 1/8th of a point". This would mean that the interest rate on a consolidation loan is the weighted average of the interest rates on the component loans, eliminating any penalties for consolidation.

3. Establish parity among the FFEL and FDSL programs, so that students do not have to negotiate minute subtle differences between the programs. For example, make the income contingent repayment provisions available in both programs and allow students in both programs to consolidate their loans during the in-school period. Likewise, the loan discharge rules for death or disability for both programs should be aligned. All borrowers should have the same benefits regardless of program. The only differences should occur where lenders choose to compete on cost and quality of service.
In addition, allow direct lending to reduce interest rates for students who repay their loans on time and/or through EFT and allow other measures that are either cost neutral, reduce costs, or enhance collections.

4. Eliminate the single lender rule for loan consolidation and other rules that complicate the choice of a consolidation lender, allowing students to choose any participating lender to consolidate their student loans, regardless of whether the student's loans are held by a single lender or multiple lenders. Not only will this simplify the process, but also it will promote competition among lenders, leading to reduced student costs and improved quality of service.

On the other hand, the existence of the single lender rule allows lenders a longer period in which to recoup their costs and earn a return on the loan. Lenders have argued that eliminating this rule will make originating loans less profitable, with the result that all lenders will become consolidators and none will want to be originators. Perhaps there is a middle ground which will allow lenders to hold the loan long enough to realize a reasonable return on investment, while still allowing students to choose from among several lenders competing for their business.

This proposal should be considered in conjunction with the proposal to eliminate the loan origination fees (see below). Eliminating both the origination fees and the single lender rule might yield too severe an impact on lenders. Most lenders would probably prefer to eliminate the origination fee (as currently implemented) while retaining the single lender rule.

5. Eliminate the distinction between interest rates for the in-school/grace periods and the repayment periods, replacing them with a single interest rate. The new interest rate should represent a revenue-neutral reduction in the repayment rate. Make this change in the interest rates apply on a going-forward basis to all loans issued since July 1994.

6. Eliminate other penalties for consolidation, such as the inability of Perkins borrowers who consolidate to take advantage of forgiveness and deferment provisions, the loss of interest subsidies, and the loss of certain death and disability discharge provisions upon consolidation.

7. Use a single definition of financial need and one definition of eligibility for all student aid programs.

8. Give state prepaid tuition plans more favorable need analysis treatment, similar to that of section 529 plans. This means treating them as an asset of the account owner for financial aid need analysis purposes, instead of as a resource. This will encourage more families to save money for college by eliminating a disincentive to saving. Fold Education IRAs into the section 529 plan program.

9. Currently, the favorable tax treatment accorded to section 529 plans by the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) is set to expire on December 31, 2010. Such legislative uncertainty is at odds with the goal of encouraging families to save for their education on a long-term basis. Accordingly, the provisions of the EGTRRA as they relate to section 529 plans should be made permanent.

10. Either repeal the law that bans convicted drug offenders from receiving federal student aid, or amend it to (a) exclude minor offenses and (b) include individuals convicted of violent crimes (murder, rape). Title IV student aid programs should not be encumbered with provisions aimed at achieving compliance with federal laws that are unrelated to education. If such provisions must be included, at least make them consistent and effective.

11. Eliminate loan origination fees or replace them with a flat dollar amount. The cost of originating or servicing a loan does not increase with the amount of debt. The inclusion of loan origination fees has led to lenders manifesting a preference for students who are more likely to borrow at a higher level of indebtedness. Encouraging higher levels of indebtedness is not good public policy. Moreover, the origination fees were originally intended to be a temporary measure.

This proposal should be considered in conjunction with the proposal to eliminate the single lender rule (see above). Eliminating both the origination fees and the single lender rule might yield too severe an impact on lenders. Most lenders would probably prefer to eliminate the origination fee (as currently implemented) while retaining the single lender rule. If origination fees are retained, they should be paid to the lender, not the government, to ensure continued loan originations.

12. Expand upon the experimental sites approach. Incorporate the results of some of the successful past experiments into Reauthorization, such as adopting single disbursements for single-term loans and eliminating the 30-day delay for loan disbursements. Use the experiments to test potential future improvements and simplifications to federal student aid programs, in addition to streamlining the regulatory burden. This will lead to an effective propose-test-evaluate-adopt cycle for future improvements to Federal programs.
13. Consolidate all Title IX graduate grant programs into a single graduate grant program with centralized administration.

14. Eliminate any input figure on the Free Application for Federal Student Aid (FAFSA) and the Federal Need Analysis Methodology that does not make a difference of greater than 10% in the Expected Family Contribution (EFC) figure for more than 10% of the applicants. This will simplify the form, yielding a process that is easier for families to understand. For an example, see FinAid’s Quick EFC estimator, which mathematically eliminated input variables that did not lead to significant variations in the expected family contribution. This reduced the number of input variables by a factor of six, eliminating more than 50 questions. Several major foundations have adopted FinAid’s Quick EFC estimator as the basis for need-based awards because it is much less intimidating than the full EFC formula, yet yields similar results.

ENHANCEMENTS TO EXISTING PROGRAMS

A college education is an investment in the future of the individual and in the future of society. It pays dividends in the form of higher lifetime income for the graduate and higher income tax revenues for the government. A college graduate, for example, will contribute nearly $100,000 more in federal income tax over the course of a lifetime than someone with only a high-school diploma. Society also benefits from the lower crime rates, decreased poverty, and improved health of a more educated citizenry. Infant mortality is also correlated with the education of the baby’s parents. A well-educated populace is more involved in the community, volunteers to help the less fortunate, and contributes more to charities.

When you total all the benefits, every dollar invested in a higher education yields a five-fold return on investment. Given such incredible economic and social gains, it is time for the Federal government to make a major commitment to higher education, a commitment that is an order of magnitude greater than any previous effort. It is time for Congress to make college education the top national priority. It is time to set bold new goals for higher education. It is time to take aggressive steps toward achieving those goals. It is time to start investing in human potential. If we start now, we will see tremendous benefits in less than a generation.

The first two recommendations in this section are essential to improving access to higher education.

1. Increase the maximum Pell Grant to $7,000 and the average Pell Grant to $4,000. This would restore the Pell Grant to the buying power it had in the mid-70s. The Pell Grant program is the major source of federal aid for low-income college students, who tend to have a greater fear of debt than middle and upper-income students. In addition, lower income students have a greater tendency to work excessive hours to support their families while in college, negatively impacting retention rates.

Such a major infusion of cash into the Pell Grant program will not only improve access to higher education among lower income families (a profitable investment in human capital), but it will send a clear message about the value of a higher education. Such a strong commitment by Congress will lower barriers and encourage greater matriculation and retention.

2. Increase the annual and cumulative unsubsidized loan limits for the Federal Stafford Loan program, both for undergraduate and graduate students. The loan limits haven’t been increased in over a decade, and are no longer adequate at even low-cost public colleges.

   a. Adopt a uniform loan limit for all undergraduate years, instead of having lower limits for the freshman and sophomore years. Increase the annual loan limit for dependent undergraduate students to $7,500 per year and adjust the cumulative loan limit accordingly. Likewise, increase the additional loan limit for independent students and students whose parents are unable to obtain a PLUS loan to $5,000 per year regardless of year in school.

   [The argument in favor of keeping annual maximums tiered is to address the high attrition rate among freshmen and sophomores. Tiers minimize the debt burden among students who drop out. On the other hand, students and parents report that the tiers simply lead to increased borrowing from private loan programs during the first two years of the undergraduate program. Nevertheless, even if we retain tiers and front-loaded grants, the tiered annual loan limits need to be increased. If tiered loan limits are retained, then perhaps the Pell grant should be front-loaded, with the difference in loan limits translating into corresponding increases in the Pell grant during the freshman and sophomore years. But why do we want to base lending priorities on the anticipation of failure, instead of focusing on what students need to succeed?]"

   Regardless of whether the loan limits are tiered or not, there is a broad consensus that the annual and cumulative loan limits need to be increased.

   b. For graduate students, eliminate annual and cumulative loan limits, instead allowing graduate students to borrow up to the full cost of education less other aid received as an unsubsidized
Stafford Loan (i.e., similar to the current PLUS Loan program). If there must be an annual loan limit for graduate students, increase it to at least $38,500 per year. (For example, currently medical students can borrow up to $38,500 a year through the Stafford Loan program, but law and doctoral students cannot.)

c. In addition to the annual and cumulative limits, all education debt should be capped at the cost of education (student budget) less other aid received, if it happens to be lower than the annual limits. This will prevent students at low-cost public institutions from over-borrowing.

d. Schools should be permitted to institute lower annual limits according to the degree program, field of study, or other non-discriminatory criteria, in order to restrict excessive borrowing by students.

Not only would these changes streamline the program, but also the increased limits would allow students whose parents are unable or unwilling to borrow to pay for their education to pay for the cost of college on their own. Fear of debt, whether by the student or the parent, is a barrier to access.

3. Make the Pell Grant program a true entitlement, and index the maximum grant amount to inflation.

4. The current SSIG and FSEOG programs are ineffective at leveraging increased state support of higher education. State investment in higher education has been declining steadily in most states for decades. These federal programs effectively replace or supplement state funding without encouraging an increase. There are great inconsistencies and inequities in the funding levels awarded to schools through these programs. Eliminating these programs and rolling the funding into increased Pell Grants would better serve students.

The main argument against eliminating SEOG appears to be the greater packaging flexibility, in that schools with greater amounts of SEOG funding are able to provide SEOG funding to students who are not Pell eligible.

5. Modify federal treatment of outside scholarships (e.g., overaward regulations) to leverage increased support of higher education by private foundations, charities and philanthropists. Currently, if a student wins an outside scholarship, their need-based financial aid package is reduced by the amount of the scholarship, yielding no net benefit to the student. Moreover, since the schools reduce institutional funds before touching government loans and grants, this regulation also yields no net benefit to the federal government. The package reduction is contrary to the sponsor's goals, which are to provide additional help to a particular type of student. The only exception is when a school's outside scholarship policy uses the outside scholarship to reduce loans instead of grants. One possibility would be to increase the overaward tolerance or to make outside scholarships fully or partially exempt from overaward regulations.

6. Improve the income-contingent repayment (ICR) plan as follows:

   a. Reduce the number of years before the balance is forgiven to 15 years for students who have spent at least 5 years in full-time public service (e.g., work for government or tax-exempt non-profit organizations).

   b. Eliminate the marriage penalty inherent in the design of the ICR program.

   c. Eliminate the taxation of forgiveness for income-contingent loans that are forgiven.

The cost of these changes is negligible, but will remove additional barriers to the pursuit of a public service career.

7. Make scholarships, fellowships, and assistantships exempt from income tax and FICA, up to the cost of education, provided that they are funded and awarded competitively by a non-profit tax-exempt organization.

8. Loan forgiveness provisions for teachers, nurses, and other national need areas should be expanded.

MODIFICATIONS TO NEED ANALYSIS

The current Federal Need Analysis Methodology is complex and lacks transparency. Most families feel that the Expected Family Contribution does not accurately reflect their true ability to pay. Instead, it is little more than a rationing system. The following proposals are intended to yield a formula that is fairer and easier to understand.

1. Eliminate the distinction between student assets and parent assets, using instead a combined "family assets" figure. This will eliminate penalties for parents who conscientiously save for their children's education by putting the money in the child's name.

2. Likewise, eliminate the distinction between student income and parent income. This would have important consequences for low-income families where student income is a significant contributor to the family's basic living expenses and hence is not as available for funding college costs. The 2001 change in the need analysis
methodology to allow a parent’s negative “adjusted available income” as an offset against student income was a step in this direction.

3. Change some of the tests for household membership, such as identifying the custodial parent in divorce cases and dependents other than a spouse, to be based on the source of support (e.g., the 50% support test).

4. Modify the need analysis formulas to consider education debt (public and private). Currently, the need analysis formula ignores education debt, meaning that a family with no education debt is considered to be just as needy as a family with high education debt, even though the latter family's net worth is lower. Parents who are still paying off their own student loans do not have the same ability to pay as a family with no existing education debt.

Education debt should be treated as an allowance against assets. This will yield an expected family contribution figure that more accurately reflects the family's ability to pay.

Please note that this recommendation is NOT trying to provide more aid to families with high debt than to families with no debt. Rather, it recognizes that families with the same net worth should get similar amounts of aid.

5. Alternately, completely eliminate the consideration of assets from the need analysis formulas. This will eliminate actual and perceived penalties for saving.

6. Clarify when the rental or purchase of a computer can be added to the cost of attendance, and allow the purchase to occur before the student's first day of class. This will allow parents to purchase a computer in the spring as a graduation gift.

7. Modify need analysis to use family income information from the prior prior-year (PPY) income tax return instead of the prior year (PY) tax return. This would provide the following benefits:
   a. It permits the aid application process to start earlier, allowing students to submit financial aid applications at the same time as college admissions applications, even for early action and early decision programs.
   b. It allows schools to provide more accurate estimates of financial aid eligibility to high school juniors.
   c. It allows colleges to base financial aid awards on actual income instead of estimated income. This will increase the accuracy of the need analysis process.
   d. It permits automated income verification through an exchange of information between the IRS and the US Department of Education. This will reduce the likelihood of fraud and common errors (e.g., families who report the amount withheld or the amount due with the return instead of the actual income tax).
   e. The FAFSA form could potentially be replaced with a postcard, since most of the financial information could be obtained automatically from the IRS. This would reduce administration costs. Further streamlining could be obtained by replacing the number in family figure with the number of exemptions listed on the tax return and by imputing assets from income. (If one imputed assets, then both actual assets and debt could be ignored.)

PPY would not result in an increase in verification or requests for professional judgment, as the current system based on PY income is just as bad a predictor of award year income as PPY income. Annual income is extremely volatile. To the extent that PPY would provide several advantages, it is worth instituting despite the perceived (but not actual) decrease in accuracy.

If PPY is not adopted, at least pursue an automated data match with the IRS to verify income for all aid recipients (or at least all grant recipients), instead of relying on schools to manually verify a subset of students. Students should only be selected for manual verification when automated verification identifies an error or anomaly or likely misrepresentation. Data match badly needs to be sped up, especially the updates to student status, in order to eliminate delays in the disbursement of aid. (A student could graduate college while waiting for the INS, SSA, or VA to correct their records!)

8. Add a new method of determining independent student status, where the student lives on his/her own and is genuinely self-supporting. The student must provide at least 50% of his or her support and his or her income must exceed the poverty line and not be based on direct or indirect support from current or former parents or guardians. The purpose of this change is to codify current professional judgment practice, to eliminate inconsistencies in the treatment of students who have been forced to live on their own.
OTHER IMPROVEMENTS

1. The current rules for determining veteran status for student financial aid purposes are unclear and inconsistent. Differences with the veteran status as specified by the Veteran's Administration lead to data match problems. Consider the following examples:
   a. A member of the National Guard or Reserves is called to active duty (not training) to serve a limited period of time. This service member is then considered to be a veteran for financial aid purposes even though they have reverted to Reserve Component status.

   A member of the armed forces who has been serving on active duty for several years, however, is not considered a veteran for financial aid purposes because he/she has not yet been discharged from active duty.

   b. A cadet in the Academy preparatory school who is discharged for medical reasons is considered a veteran for financial aid purposes.

   A ROTC cadet who is contracted in the advanced level training but fails the military medical exam before commissioning is not considered a veteran for financial aid purposes.

   c. A service member remains on active duty beyond the first term of enlistment. Since he/she is still on active duty, they are not considered a veteran for financial aid purposes.

   d. A service member who is discharged from active duty because of violations of the UCMJ and receives an "other than dishonorable" is considered a veteran for financial aid purposes.

   A service member who serves honorably, remaining on active duty, however, is not a veteran for financial aid purposes until he/she is discharged.

   e. A service member is unmarried and serving on active duty in the Armed Forces. He is considered "dependent" because he is not yet 24 years old and has not yet been discharged from active duty.

The definition of a veteran for financial aid purposes should be changed to better match a common sense interpretation of what it means to have served our country. Junior enlisted personnel receive such low pay that their families are often eligible for welfare and food stamps. Their income is below the poverty lines established by the Bureau of Labor. Yet the Higher Education Act denies these people the opportunity to gain a college education while they serve on active duty.

Perhaps it would be better to use the same definition of “Veteran” as the VA uses, to enable a more definitive match process.

2. Perform a comprehensive survey of college uses of professional judgment, with a goal of identifying common practices that can be codified and perhaps automated.

3. Establish a competitive scholarship program for international students, providing full funding for two students from each country to pursue an undergraduate or graduate degree in the United States.

4. Eliminate the taxation of scholarships and fellowships. Before 1986, amounts used for living expenses such as room and board were not taxed. Restoring the tax law to its previous position would make the treatment of scholarships and fellowships consistent with the current treatment of section 529 plans.

Thank you for considering these proposals for the 2003 Reauthorization of the Higher Education Act of 1965.