Student Lending 101

A Regulator’s Guide to What Students Need to Know

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Federal Loans

- **Federal Perkins Loans are:**
  - Made through participating schools to undergraduate, graduate and professional degree students.
  - Offered by participating schools to students who demonstrate financial need.
  - Made to students enrolled full-time or part-time.
  - Repaid by the student to the school.

Federal Loans

Stafford Loans:

- Stafford Loans are for undergraduate, graduate and professional degree students. The student *must* be enrolled as at least a half-time (at least 6 credit hours) student to be eligible for a Stafford Loan.
  - Subsidized Loans – Student must demonstrate financial need. ED pays lender for interest while the student is in school, in grace, and in deferment status.
  - Unsubsidized Loans – Financial need not required.
- PLUS Loans (Direct or FFEL) are loans parents can obtain to help pay the cost of education for their dependent undergraduate children. In addition, graduate and professional degree students may obtain PLUS Loans to help pay for their own education.
- Consolidation Loans (Direct or FFEL) allow student or parent borrowers to combine multiple federal education loans into one loan with one monthly payment.

Federal Loans

William D. Ford Federal Direct Loan (Direct Loan) Program:

Loans made through this program are referred to as **Direct Loans.** Eligible students and parents borrow directly from the U.S. Department of Education at participating schools. Direct Loans include subsidized and unsubsidized Direct Stafford Loans (also known as Direct Subsidized Loans and Direct Unsubsidized Loans), Direct PLUS Loans, and Direct Consolidation Loans. Payment is made directly to ED.

Federal Loans

Federal Family Education Loan (FFEL) Program:

- Loans made through this program are referred to as **FFEL Loans.** Private lenders provide funds that are guaranteed by the federal government. FFEL Loans include subsidized and unsubsidized FFEL Stafford Loans. FFEL PLUS Loans and FFEL Consolidated Loans. Payment is made to bank or private lender that made the loan.

Student Loan Comparison Chart

Loan Program	Eligibility	Award Amounts	Interest Rates	Lender/Length of Repayment
Federal Perkins Loans	Undergraduate and graduate students.	Undergraduate - up to \$4,000 a year (maximum of \$20,000 as an undergraduate). Graduate - up to \$6,000 a year (maximum of \$40,000, including undergraduate loans). Amount actually received depends on financial need, amount of other aid, availability of funds at school.	5 percent	Lender is the school. Repay the school or its agent.
FFEL Stafford Loans (subsidized and unsubsidized)	Undergraduate and graduate students; must be enrolled at least half-time (6 credit hours).	Depends on grade level in school and dependency status. Financial need is required for subsidized loans. Financial need not necessary for unsubsidized loans.	Fixed rate is 6.0% percent for loans first disbursed on or after July 1, 2008. The federal government pays interest on subsidized loans during school and certain other periods. The borrower pays all interest on unsubsidized loans.	Lender is a bank, credit union or other participating private lender. Repay the loan holder or its agent. Between 10 and 25 years to repay, depending on amount owed and type of repayment plan selected.

Student Loan Comparison Chart

Loan Program	Eligibility	Award Amounts	Interest Rates	Lender/Length of Repayment
Direct Stafford Loans (subsidized and unsubsidized)	Same as above.	Same as above.	Same as above.	Lender is the U.S. Department of Education; repay Department. Between 10 and 15 years to repay, depending on amount owed and type of repayment plan selected.
FFEL Plus loan	Parents of dependent undergraduate students enrolled at least half-time. Graduate or professional degree students enrolled at least half-time. Borrower must not have negative credit history.	Student's Cost of Attendance - Other aid student receives ________________ = Maximum loan amount	Fixed rate as 8.5 percent for loans first disbursed on or after July 1, 2006; borrower pays all interest.	Same as FFEL Stafford Loans above.
Direct Plus Loans	Same as above.	Same as above.	Fixed rate at 7.9 percent for loans first disbursed on or after July 1, 2006; borrower pays all interest.	Same as for Direct Stafford Loans above, except that the income Contingent Repayment Plan is not an option.

What Options are Available When Federal Programs are Exhausted?

- College Savings Plans
- Rewards Programs
- Tuition Payment Plans
- Alternative/Private Loans
- Direct to Consumer Loans
- Institutional Loans

1-2-3 Approach

- Maximize the use of grants, scholarships, payment plans and federal programs as the lowest cost methods to pay for college.
  - 1: Free money first
  - 2: Federal loans second
  - 3: Private Loans third

Programs to Supplement to Federal Loan Programs

- College Savings Plans: allows individuals to save money for college in a tax deferred account (529 Plans)

- Rewards Programs: Allows members to earn rebates that can be used to pay higher education expenses (Upromise)

- Tuition Payment Plans: Interest free option that allows students to pay tuition to the school in installments over a number of months rather than in one payment at the beginning of the semester. (TuitionPay)

Alternative/Private Loans

- Loans are funded and guaranteed by a lender
  - No federal backing
- Marketed to students in coordination with the school and within the school's process
  - Certified by the school
- Approval is based on credit-worthiness of applicant and/or cosigner.
- Interest rates are typically variable
  - Based on Prime, LIBOR or T-bill
- Students can borrow up to the cost of attendance.
- Many loans are deferred while the student is in school.

Direct to Consumer Loans

- Direct to Consumer Loans: Loans are funded and guaranteed by a lender with no federal backing
  - Marketed directly to students outside the school's process
  - Not certified by the school
  - NASFAA bill to eliminate non-certified programs

Institutional Loans

- Institutional Loans: Loans are funded by the school directly to the student with no federal backing.
    - School sets underwriting criteria
    - School sets interest rate and fee structure
    - Handled as formal promissory note or accounts payable
    - Administered by the school or by a third party
    - Many schools sell the loans to a third party

Update From Washington

Final Regulations Published November 1, 2007.

Preferred Lender lists (34 CFR 682.212(h))

- School may choose to have preferred lender(s) list (includes web processes).
- List must have at least 3 unaffiliated lenders.
- Must disclose method/criteria for lender inclusion on the list.
- Must provide comparative information on borrower benefits offered by listed lenders.

Update From Washington

<u>Preferred Lender lists (34 CFR 682.212(h)) (cont'd)</u>

- Must include prominent statement advising borrowers that use of school preferred lender not required.
- Cannot cause any unnecessary delays in certification for borrowers not using one of the school's preferred lenders.

Update From Washington

Prohibited Inducements (34 CFR 682.200(b))

- Affects FFEL lender and guaranty agency (GA) eligibility and participation on the program.
- Creates concept of “rebuttable presumption” for prohibited and allowed activities.
- Includes a non-exhaustive list of prohibited activities.
- Includes a list of allowed activities.

Update From Washington

<u>Prohibited Inducements (34 CFR 682.200(b)) (cont'd)</u>

- Prohibited activities include:
  - Payments to prospective borrowers, including prizes and additional financial aid.
  - Payments or other benefits to a school, school-affiliated organization, or individual for loan applications, volume of loans made, or placement on a preferred lender list.
  - Payments or other benefits to student lender reps on campus or other solicitors to secure loan applications from prospective borrowers.
  - Solicitation of an employee of a school to serve on lender's advisory board and/or payment of costs to serve on advisory board.

Update From Washington

<u>Prohibited Inducements (34 CFR 682.200(b)) (cont'd)</u>

- Prohibited activities include:

  - Payments of referral or processing fees to another lender or other party.
  - Payments of conference or training registration, transportation, and lodging costs for school or school-affiliated organization employees.
  - Undertaking philanthropic activities in exchange for FFEL applications, volume, or placement on a school's preferred lender list.

Update From Washington

Prohibited Inducements (34 CFR 682.200(b)) (cont'd)

- Allowed activities include:
  - Assistance to schools comparable to that provided DL schools by the Secretary.
  - Support or participation in student aid/financial literacy outreach with schools and guaranty agencies (except for in-person school-required entrance/exit counseling).
  - Toll-free numbers for FFEL info and school loan data transmission.

Update From Washington

Prohibited Inducements (34 CFR 682.200(b)) (cont'd)

- Allowed activities include:
  - Reasonable costs of meals, refreshments and receptions for meeting, training, or conferences if open to all attendees.
  - Reduced origination fees and interest rates.
  - Payment of Federal Default Fees.
  - Borrower benefits under repayment incentive programs.
  - Items of nominal value.

Update From Washington

<u>Prohibited Inducements (34 CFR 682.200(b)) (cont’d)</u>

- Allowed GA activities include:
  - Payments for default aversion activities approved by the Secretary.
  - Payments for expenses related to participation in GA’s governing board, official advisory committee, or for other official GA-sponsored activities.

Update From Washington

- Secretary Spellings issues Dear Colleague letter (GEN-08-03) providing assistance for the implementation of a Lender-of-Last Resort program by a guaranty agency.

How Did We Get Into This Student Loan Crisis?

- February 2007: New York Attorney General, Andrew Cuomo, begins to investigate relations between lenders and educational institutions.
- November 1, 2007: ED publishes final regulations changing anti-inducement provisions.
- Subprime mortgage crisis emerges.
- September 27, 2007: *College Cost Reduction and Access Act of 2007* enacted - $20 billion cut from lender and guaranty agency fees.
- More than 50 lenders representing 12% of loan volume dropout of FFEL Program as of April 10, 2008.

How Did We Get Into This Student Loan Crisis?

- Secretary of Education Spellings advises Congress that she is holding meetings with Treasury Secretary Henry Paulson, to ensure the availability of student loan capital.
- Congressmen and Senators send letters to the Secretaries of Education and Treasury demanding that the administration take actions to address impending crisis of loan access.
- Senator Edward Kennedy (D-MA) and Congressman George Miller (D-CA) each introduce legislation to ensure that the tightening of the credit markets does not prevent students or families from accessing funding they need to pay for college.
- On 4/9/08, House Committee on Education and Labor reports *H.R. 5715*, *The Ensuring Continued Access to Student Loans Act of 2008*, to ensure that students and parents have access to student loan funds.

What is the Future of Private Lending?

- Significant legislative cuts and severe credit deterioration have caused lenders to exit the federal student loan program
  - Many private lenders have exited the space as well
- All remaining lenders have tightened underwriting criteria
- School-backed programs have been reduced/eliminated
- Result:
  - Students with blemished credit and no credit-worthy cosigner may see reduced access
  - This will place greater reliance on tuition discounting and on institutional loan programs

Student Protection – Consumers Union Study

<u>Helping Families Finance College</u> (Published July 2007)
Michael Wroblewski, Project Director

- Research conducted in five metropolitan areas - 130 students and parents.
- Recommendations for US Department of Education, state regulators, and lenders include:
  - Early emphasis on the need to comparison shop for federal and private loans
  - Emphasize financing order – free money first, scholarships/grants/work study next, federal loans, then private loans. Discourage credit card usage
  - Standardize key components of financial aid award letter
  - Provide “plain English” disclosure of all rates and terms of loans
  - Require student loan borrowers to participate in annual online financial literacy counseling prior to loan disbursements
  - Develop public profiles on all student loans
  - Report all rates and terms for private loans to US Dept. of Education
  - Improve the National Student Loan Data System (NSLDS) to maintain records of all students’ federal and private loan info, including projected payment amounts.

Student Protection

Can lending be regulated?

- 4/2/07 - NYS Office of the Attorney General announced that it entered into agreements with lenders and schools, which resulted in a Code of Conduct.
  - Prohibits revenue sharing from lenders to schools, includes disclosure standards and restriction on how lenders are chosen for school ‘preferred lender’ lists, and bans gifts or trip to university employees from lenders. Also prohibits lenders from staffing any component of an institution’s financial aid office and outline guidelines for other aspects of lender/school relationship.
  - Precursor to SLATE legislation

Student Protection

NYS Slate Act – Article 13B

- **Student Lending Accountability and Transparency Enforcement Act**

  - Passed NYS legislature unanimously in May 2007.
  - Regulations currently in draft, scheduled for vote by the NYS Board of Regents 5/08. Requires funding to create a bureau in SED to implement statute.
  - Turns NYS Office of the Attorney General's 'Code of Conduct' into law

Student Protection – SLATE

- Prohibits lending institutions from making gifts to institutions and their employees in exchange for any advantage or consideration provided to the lending institution related to educational loan activities.
- Bans institutions and their employees from soliciting, accepting or receiving gifts from lending institutions for any advantage related to educational loan activities.
- Bans institution employees from receiving any renumeration for serving as a member of a lending institution's advisory board.
- Prohibits employees and/or agents of the lending institution from posing as institution employees, including staffing the institution's financial aid offices with employees of the lending institution.
- Bans lending institutions and institutions from agreeing to certain quid-pro-quo high-risk loans that would prejudice potential borrowers.
- Requires any institution that makes available a preferred lender list to potential borrowers to disclose the process by which the covered institution selects lending institutions for such preferred lender list and require that the list shall contain a statement that borrowers have the right to select the education loan of their choice.
- Prohibits institutions from linking or directing potential borrowers to any electronic master promissory notes or other loan agreements that do not provide a reasonable and convenient alternative for the borrower to complete a master promissory note with any federally approved lending institution offering the relevant loan in the state.
- Requires lending institutions to disclose to institutions, upon request, the historic default rates of the borrowers from the institution, the interest rates charged to borrowers and the number of borrowers obtaining each interest rate.
- Authorizes the Department to impose a civil penalty on any covered institution, covered institution employee or lending institution that violates any provision of SLATE.

Student Protection

NYS Education Department has a significant investigative, quasi-judicial and fiduciary responsibility to implement the new law, including the following:

- Institution employees are required to report to SED any instance of a lending institution attempting to give a gift to such employee.
- Institution employees who are directly involved with or benefit from the functions of the covered institution's financial aid office are required to submit a financial disclosure form to the Department as it relates to any financial interest or ownership in lending institutions identified on the covered institution's preferred lender list.
- Lending institutions are required to file an annual statement with SED, identifying the criteria they utilize for underwriting high-risk loans or providing opportunity loans for each covered institution they serve.
- For any violation of the provisions in SLATE, a hearing must take place and civil fines may be imposed.
- Any alleged violations must be investigated and appropriate evidence must be secured for use at a hearing for presentation to a hearing officer.
- Covered institutions are required to disclose pertinent information (i.e., interest rates, repayment terms, late payment penalties, etc.) to all students requesting information on a loan. All student complaints which must be investigated and may lead to a hearing.
- The Department may collect fines for violations of SLATE and shall use the revenue from such fines to:
  - Operate a grant program to award covered institutions funds to initiate education programs to educate potential borrowers on the educational loan process; and/or
  - Repay borrowers who paid an inflated price for a loan caused by revenue sharing agreements between a covered institution and a lending institution.

Student Protection

How can regulators help students understand what they are signing and assist them in making the right choices?

- Make financial literacy training (budgeting, income & expenses, use of credit, etc.) available to students.
- Require transparency regarding loan terms (interest rates, fees, etc.) SLATE is NYS’ attempt.
- Encourage student to evaluate the terms of each loan – not the incentives.
- Encourage students to continue shopping for loans & scholarships every year, even after enrollment.

Final Comments

Additional Resources

- **U.S. Department of Education –** Website features information on Federal Student Aid, Applying for College Aid, Default Rates, and a section that allows students to track their aid history.
  www.ed.gov

- **U.S. Department of Education –** List of all publications available to the public, including the “Counselors and Mentors Handbook on Federal Student Aid” and “Funding Education Beyond High School” - for students and parents.
  www.FSApubs.org

- **Federal Aid First -** A brochure issued by the U.S. Department of Education, listing the various federal loan options, and supplying tips for applying for federal loans. Brochures can be ordered at no cost, or downloaded in PDF version.
  www.ed.gov/federalaidfirst/index.html

- **National Association of Student Financial Aid Administrators –** Website for financial aid administrators, students, and parents, containing up-to-date information on all aspects of financial aid. This is an excellent resource, which is updated on a daily basis.
  www.nasfaa.org

Final Comments

Additional Resources

- **National Consumer Law Center –** The NCLC created a website, dedicated solely to student lending issues.
  www.studentloanborrowerassistance.org
- **Borrow Smart -** An educational video, written and produced by Kiplinger, offering tips for college savings, reducing expenses, and accessing scholarship and grants.
  www.kiplinger.com/money/payingforcollege
- **USA Funds Education Access Report –** Contains various topics of interest to students, parents, and schools. A few current updates include lenders of last resort, debt management perspectives, and updates on what is happening at the federal level, in regards to the lending crisis.
  www.usafunds.org/news/index.html
- **Foundation Center** – Offers assistance in finding private scholarships and grants.
  www.foundationcenter.org