

*What We Have: An Overview  
of the Student Loan Process*  
**Interview Panel**

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# Bloomberg

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## Indentured Students Rise as Loans Corrode College Ticket

By Janet Lorin - Jul 9, 2012

Geraldine Damiani Brezler took out a \$5,000 student loan in the late 1960s to study at the State University of New York. She became a nurse, got married, bought a house and repaid the debt in less than three years.

Today, her son, David, 38, owes about \$85,000 in loans for a master's degree in education at New York University. He can't find full-time work, lives with his parents in White Plains, New York, and has deferred paying his debt for three years.

The financial-aid odyssey of two generations of Brezlers tracks the history of U.S. student loans, which, like the home mortgage, helped define the American dream. In the early years, the loan program let ambitious teens take on a small debt that could pay off with a lifetime of higher earnings. Now, the \$1 trillion in outstanding student debt has become a drag on the economic recovery, a flashpoint in the presidential election and a threat to the egalitarian ideals of U.S. higher education.

"It's like waking up to a snarling wolf every morning," said David Brezler, who spends his days searching job listings, following up by e-mail and phone and taking on short-term consulting jobs. "The idea of buying a house -- it's completely inconceivable."

How did a once-modest federal program spiral out of control, weighing down low- and middle-income families like the Brezlers that it was designed to help?

### 'Indentured Student'

The answer echoes both the health-care and mortgage crises. As college costs have soared faster than the rate of inflation over the past four decades -- reaching \$60,000 a year at the most expensive private schools -- Republicans and Democrats alike postponed a reckoning. They encouraged borrowing and ignored surging tuition, leaving loans to balloon to the size of mortgages, shocking even the system's own architects.

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“No one ever conceived this was a way to create a debtor class of former students, the indentured student,” said Tom Wolanin, who worked on federal higher education policy for 30 years and was a deputy assistant education secretary in the Clinton administration.

Politicians of all stripes ignored repeated warnings that the day would come when debt would become unsustainable.

“The path of least resistance was to have the student borrow more,” Wolanin said.

Congress, during the administrations of Jimmy Carter, Ronald Reagan, George H.W. Bush and George W. Bush dangled more credit to more families. The U.S. raised the total amount that dependent students could borrow during their college careers to \$31,000, up from \$7,500 when the loan program began, according to an April Congressional Research Service report. Under certain circumstances, the limit for dependent students is even higher.

## **Election Issue**

In the final stretch to this year’s presidential election, college costs and debt are looming larger than ever. In a January speech at the University of Michigan, President Barack Obama proposed rewarding schools that control costs with access to more loans and grants. In June, at the University of Nevada, Las Vegas, he touted an executive order that eases the application process for a loan program that lets students make lower payments tied to their incomes, stretching them over decades.

“I want to make it easier for more students like you to earn a degree without shouldering a mountain of debt,” Obama said.

In his education plan released in May, Republican presidential candidate Mitt Romney said Obama’s financial-aid initiatives encourage students to take on more debt, “claiming to help them today and then sending them the bill tomorrow.” Romney advocates cutting education regulation and encouraging colleges to become more efficient, lowering costs partly through the use of online instruction.

## **Building Boom**

The government began offering loans to all college students regardless of income in 1992. At the same time, it let parents borrow up to the cost of attendance minus any financial aid. Congress endorsed almost unlimited borrowing for graduate students in 2006, the same year it let federal grants and loans be used for online programs, especially at for-profit schools targeting working adults.

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As borrowing soared, university presidents began a multibillion-dollar building boom across campuses, featuring private dorm rooms and network TV-ready football fields. Colleges themselves went into debt to pay for these extras. By the end of 2011, more than 500 colleges and universities rated by Moody's Investors Service had \$211 billion of outstanding debt, compared with \$91 billion in 2002.

"The tendency of the colleges and universities at the undergraduate or the graduate level is to charge as much as they can, and continue to build and expand," William Bennett, education secretary under Reagan, said in an interview.

### **Access Surges**

Federal loans have enabled the number of college-goers to more than triple, to 21.6 million in 2010 from 5.9 million in 1965, Education Department data shows. The average debt held by members of the class of 2010 was \$25,000, according to a report by The Institute for College Access & Success in Oakland, California.

For most graduates, that level of debt is manageable, said Sarah Flanagan, a lobbyist for the National Association of Independent Colleges and Universities, which represents more than 1,000 private, nonprofit schools.

Yet, a survey last year by the Washington-based Pew Research Center found that more than half of U.S. adults said higher education failed to provide "good value" for the money, three-quarters said it was unaffordable for most Americans and almost half said the loans made it harder to pay other bills.

Some scholars are coming to a conclusion that shakes at the core of a long-held belief: College may not be for everyone.

### **'Mindlessly Drifting'**

The "college for all" movement focuses too much on helping students pursue four-year degrees when two-year and other programs may better prepare them for the workforce, according to a 2011 Harvard University report.

"Mindlessly drifting into college, believing that anything they study for however many years is going to be worth going into debt for -- that's what is getting far too many young people into deep trouble," Robert Schwartz, academic dean at Harvard's education school, said in an interview.

The choices were easier for Geraldine Brezler, now 64. In addition to paying off her \$5,000 student loan in less than three years in the early 1970s, she earned enough as a nurse to pay the \$6,000 down payment on the family's first home in Akron, Ohio, while her husband began his medical career.

"When I borrowed for college, it was more like getting a car loan," she said. Regarding her three kids, who all have master's degrees, "the amount of money that they borrowed is more like a down payment on a house," she said.

## 1965 Start

The modern student-loan program was born in 1965, part of President Lyndon Johnson's Great Society. In a November ceremony at Southwest Texas State College, his alma mater, Johnson signed the bill authorizing the initiative, saying it would "swing open a new door for the young people of America."

"Education is no longer a luxury," Johnson said. "Education in this day and age is a necessity."

Under the program, the government would guarantee loans made to students by banks or private lenders and would pick up the interest while students were in college. Borrowers would start paying back one year after graduation. In 2010, under Obama, the Education Department started making all new loans directly, eliminating the role of private lenders -- a decision Romney wants to reverse.

In the 1964-1965 academic year, it cost \$1,560 on average to attend a public college, according to a 1965 speech to Congress by late U.S. Representative Carl Perkins, a Democrat from Kentucky.

## Debt 'Bondage'

Two decades later, politicians on both sides of the aisle were alarmed at the growth of the program, with more than \$35 billion of outstanding federal student loans by 1985, according to a speech that year by Representative William D. Ford, a Michigan Democrat.

"We are producing a class of indentured students who must work to free themselves from the bondage of educational debts," said Ford, who sat on the House Education and Labor Committee during the passage of the 1965 Higher Education Act. "How will the next generation afford a home or car if their disposable income is committed to paying off student loans?"

In 1987-1988, the average costs for tuition and fees at a public university were \$1,485, and \$7,048 at a private college, according to the nonprofit College Board, whose members include colleges and

universities. Bennett suggested that the availability of student loans paved the way for colleges to raise tuition at a rate that outpaced inflation.

## For-Profit Schools

“Increases in financial aid in recent years have enabled colleges and universities blithely to raise their tuitions, confident that Federal loan subsidies would help cushion the increase,” Bennett wrote in a 1987 op-ed piece in the New York Times.

The federal-aid expansion coincided with a boom in for-profit colleges, which have higher student-loan default rates than traditional colleges and rely on federal money for as much as 90 percent of their revenue. Turbocharging the growth of these institutions, George W. Bush’s administration eased regulations that capped the federal money they could receive.

Students at for-profit colleges carry the heaviest loan load: 53 percent of degree recipients had school debt of \$30,500 or more, compared with 24 percent at private, nonprofit colleges and 12 percent at public schools, according to a 2010 report by the College Board using the most recent federal data available.

In 1992, the government opened the educational loan floodgates even more. Over the next 10 years, outstanding federal student-loan debt more than tripled to about \$280 billion from about \$80 billion, according to federal data.

## Parent Borrowers

Congress under President George H. W. Bush expanded its Stafford program, which had been limited to low-income students. Students could now borrow regardless of income.

At the same time, parents could also take out loans up to the cost to attend, minus any scholarships or loans granted to the student. While parents must pass a credit check to prove they aren’t in bankruptcy, they don’t need a medical exam and there is no age limit.

The new provisions made the federal program politically appealing to middle-class voters, said Neal McCluskey, associate director of the Cato Institute’s Center for Educational Freedom in Washington.

By 2005-2006, tuition and fees at a public university were \$5,492, while the costs at a private, nonprofit college averaged \$21,000, according to the New York-based College Board. A year later, under President George W. Bush, graduate students were able to borrow up to the cost to attend, which can amount to \$100,000 or more. Universities began enrolling more students.

## More Degrees

In the past decade, Northwestern University, expanded its graduate offerings aimed at working professionals in the School of Continuing Studies to 2,000 students from 150, said Thomas Gibbons, dean of the school based in Chicago. Two-year programs cost from about \$38,000 to \$50,000, he said.

Many families like the Brezlers are asking whether graduate school is good value. About a third of people with masters' degrees make less money on average than a typical bachelor's degree holder, according to data analyzed by Stephen J. Rose, a labor economist at Georgetown University.

When Brezler's children decided to pursue graduate school, the idea was "if they got more education, they would get better jobs and would be able to pay back their degrees," Brezler said. "Now the paradigm has shifted."

The recession that began in December 2007, combined with increases in college costs, prompted more anger from students and indebted families.

Worth It?

Obama said in 2009 before a joint session of Congress that by 2020, "America will once again have the highest proportion of college graduates in the world." At the same time, others began to question whether graduating with a high level of debt was worth it.

To ease the burden on federal loan borrowers, Obama has promoted a plan that took effect in 2009, letting them make payments based on income. For those whose circumstances don't improve, their loans can be canceled in 25 years. Under a plan unveiled last year, some borrowers' debt could be canceled in 20 years.

The younger Brezlers may need help with their debt for the next few decades. While Geraldine Brezler and her husband Mario paid for their children's undergraduate educations, the three, all in their 30s, took on debt for graduate school yet haven't landed the full-time jobs they'd expected after additional schooling, she said.

## Second Master's

Their daughter, Katherine, 30, graduated from college in 2005, earned a master's degree in education and is working on a second one in urban affairs. She has defaulted on some of her loans as she tries to cobble together an income from teacher's assistant jobs while seeking a full-time teaching position.

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David, who has been at his parent's house since August, carries on with his job search. In the meantime, he freelances as a Spanish interpreter for doctors and in courtrooms from 20 hours a week to 20 hours a month. His brother Benjamin, 34, just finished a master's degree in microbiology and continues to interview for jobs.

"The hope was you get more advanced degrees and get a better job and it just hasn't panned out that way so far," Geraldine Brezler said.

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## Parents Snared in \$100 Billion College Debt Trap Risk Retirement

By Janet Lorin - Feb 2, 2012

Terry Williams borrowed about \$7,000 to earn a degree from [Spelman College](#) 38 years ago. For her youngest child, a sophomore at Belmont University in Nashville, she will take on almost \$40,000 in parental loans.

Williams, a 59-year-old widow who runs a [nonprofit](#) that helps black families navigate private-school admissions, is watching her retirement savings dwindle as she pays college bills for her three children, [Bloomberg Businessweek](#) reports in its Feb. 6 issue.

"I'll probably work until I fall dead at my keyboard," the Decatur, [Georgia](#), resident said in an interview.

It's not just graduates who are staggering under the weight of educational loans. Parents, too, are borrowing record amounts to put their kids through college, jeopardizing their retirements. With the housing crisis, many families can no longer avail themselves of one popular option for financing university studies: taking out a second mortgage.

"A plunge in [home prices](#) has erased the equity that many homeowners had just a few years ago," said [Greg McBride](#), a senior financial analyst at Bankrate.com in [North Palm Beach, Florida](#).

Federally backed educational loans to parents, at an estimated \$100 billion, make up 10 percent of the \$1 trillion in educational loans, according to data analyzed by [Mark Kantrowitz](#), publisher of the website [FinAid.org](#). The problem is more acute at some private schools, such as [Colgate University](#), Trinity College and Sarah Lawrence College, which have smaller endowments and can't offer the same financial aid as [Harvard](#) and Princeton universities.

### 'Robbing Their Future'

"Parents are facing an economic crisis because they are borrowing too much for college," said Rick Darvis, executive director of the National Institute of Certified College Planners. "They're sacrificing their current lifestyle and robbing their future retirement."

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Loans to parents have jumped 75 percent since the 2005-2006 academic year, according to Kantrowitz. That works out to an average of about \$34,000 for those with loans. With interest, the figure rises to about \$50,000 over a standard 10-year period. An estimated 17 percent of parents whose children graduated in 2010 took out loans, up from 5.6 percent in 1992- 1993, according to Kantrowitz's estimates.

The rising levels of parental debt could ripple through the rest of the economy. By the time parents are in their 50s and 60s, they should be saving for retirement instead of taking on new liabilities, said Joseph S. Messinger, a certified college planner and president of Capstone Wealth Partners Ltd. in Columbus, Ohio. Servicing those loans becomes harder as parents stop working and their incomes decline.

### **'A Lot of Money'**

"A lot of money is going to the university and college systems," Messinger said. "It's shrinking people's dollars to do other things."

Most of the parental debt is in the form of Parent Loans for Undergraduate Students, PLUS loans, which are government- issued and carry a fixed interest rate of 7.9 percent, can be used to cover the entire cost of tuition, room and board, and other expenses -- minus any aid secured by the student. While parents must pass a credit check, no collateral is required. PLUS loans cannot be discharged in bankruptcy.

Marvin Weinberger, 58, a self-employed inventor of hand tools in Havertown, Pennsylvania, owes \$105,509 in PLUS loans for his two children. Most of that has gone to cover the almost \$49,000 a year in tuition, fees, and room and board for his daughter Ariela, a junior at Muhlenberg College, a small private institution in Allentown, Pennsylvania.

### **'Looked Hard'**

"We really looked hard at the possibility of taking her out of Muhlenberg," said Weinberger. "It was such a good fit and made her feel so welcome -- academically and socially."

His son David, a sophomore at Rochester Institute of Technology, is receiving some financial aid. Both Weinberger children took out federal loans of their own.

Muhlenberg never tells "a family they have to take a PLUS loan in order to come to Muhlenberg," Chris Hooker-Haring, dean of admission and financial aid, said in an e-mail. "We simply inform families about what we can provide." The final decision is left to the family, he said.

Many of the schools with high levels of parent loans rely more on tuition and fees than on endowments. At Trinity College in Hartford, Connecticut, where annual tuition and fees are \$55,450, parents who took out federal loans borrowed an average of \$27,000 in the last academic year, according to the school. At Sarah Lawrence in Bronxville, New York, where the annual cost of attending is \$58,716, it was about \$20,000.

## Tuition Increases

Tuition and fees for private, nonprofit, four-year colleges have increased to an average of \$28,500 for the 2011-2012 academic year, up from an inflation-adjusted \$16,276 two decades ago, according to the New York-based College Board, a nonprofit group whose members include universities.

The trend shows no sign of abating. On Jan. 28, Princeton University in Princeton, New Jersey, announced that tuition and fees for the coming school year will rise 4.5 percent -- the school's biggest increase in six years. Days earlier, the board of trustees at Cornell University in Ithaca, New York, approved a 4.4 percent cost increase for undergraduates in its four colleges not supported by New York state.

"Colleges will keep doing this as long as the loans are available and as long as people keep applying," said Laura J. Clark, director of college counseling at Fieldston, a private high school in New York. "If there's a drop-off in the number of applications in the middle-income group, that's when colleges may moderate prices or come up with new strategies for helping people pay."

## Obama's Plan

President Barack Obama last week proposed linking federal aid to a college's ability to control tuition costs. The plan calls for increasing campus-based aid only for schools that limit tuition cost increases and penalizing those that don't.

The way parents are paying for college has changed over the past two decades. As recently as 10 years ago, financing college through a second mortgage was more easily accomplished because homeowners had equity from which to borrow, said Bankrate.com's McBride.

Pamela Lauzau, 63, put three children through Boston College and took a \$400,000 second mortgage on her house in Alexandria, Virginia, to do so, which funded about two-thirds of the cost. The family didn't receive financial aid.

With her husband unable to work because he has dementia, she took a job as a school bus driver for the health insurance and sells real estate. Her youngest child graduated in May.

## Second Mortgage

"I don't see a time when I'm not going to work," Lauzau said.

This month, Lauzau expects to close on the sale of her house. She won't realize a profit because of the second mortgage.

"Our advice to families is to know what you're getting yourself in for," Robert Lay, Boston College's dean of enrollment management, said in an interview. "You have a level of sacrifice that's going to be required to send your son or daughter or to a private, expensive university like Boston College."

He said families will see a return on their investment. The school's estimated cost for this academic year is \$57,000.

Parents aren't facing the financial reality about their ability to pay off these loans when they have a smaller income stream, Capstone's Messinger said. They are relying solely on faith that they'll be able to pay the money back, he said.

## 'Too Easy'

PLUS loans, in particular, are "too easy" to get, he said.

Terry Williams, the Spelman graduate, said her own parents didn't borrow any money to send her to the school, a private, historically black women's college in Atlanta.

She took out parent loans because Belmont University was a good fit for her son, Kramer, and he could be near his sister at Vanderbilt University. Belmont, a private Christian college, costs \$34,000 per year. Her son has already borrowed about \$14,000 in federally backed loans.

"We understand and greatly appreciate the sacrifices families make in order to send their children to Belmont," David Mee, associate provost and dean of enrollment, said in an e-mail. He said the university is "committed" to controlling costs.

Williams said she didn't anticipate how expensive a college education would be.

"I'm definitely hoping that the sacrifice is still worth it," she said.

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# Bloomberg

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## Fed Student-Loan Focus Shows Recognition of Growth Risk

By Caroline Salas Gage and Janet Lorin - Jan 15, 2014

Tiffany Roberson works for the state of [Texas](#) as a parole officer, teaches part time and is living with her parents after finishing a master's degree. She's held off marrying her boyfriend of four years and starting a family because she owes more than \$170,000 in federal and private student loans.

"I've never gone into default," the 30-year-old said. "What really hurts is people say I'm a bum for living at home."

Federal Reserve economists are trying to determine whether people like Roberson represent a trend that will damage U.S. growth, partly by restricting sales of houses and cars. [Student loans](#) are one of the only deteriorating pockets of [consumer credit](#), with balances and delinquency rates rising to record highs even as a strengthening economy allows Americans to reduce total borrowing.

Outstanding education debt exceeded \$1 trillion in the third quarter of 2013, and the share of loans delinquent 90 days or more rose to [11.8 percent](#), according to the [Federal Reserve Bank of New York](#). By contrast, delinquencies for mortgage, credit-card and auto debt all have declined from their peaks.

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"I'm always made very nervous by a credit market that benefits from government guarantees and is expanding very rapidly," [Jeffrey Lacker](#), president of the Federal Reserve Bank of Richmond, said in response to audience questions after a speech at a Jan. 10 Greater Raleigh Chamber of Commerce event in [North Carolina](#). "That's what we're seeing with student loans, and it's what we saw with [housing](#)."

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## Debt Analysis

Economists at the New York Fed are analyzing student debt as part of their quarterly reports on national household credit. That project emerged six years ago as the credit crisis unfolded, when the researchers and their then-boss, Timothy F. Geithner, realized there wasn't a good way to study total consumer borrowing.

They began assembling their own figures, relying on credit reports from Atlanta-based credit bureau Equifax Inc. (EFX) -- and found that information on student borrowing was particularly sparse because of gaps in the frequency and type of publicly available data.

The Department of Education releases defaults rates on federal loans once a year and only for borrowers who haven't made required payments for at least 270 consecutive days during the two- and three-year periods after they graduate or drop out. The rates don't include students with extensions -- such as deferrals and forbearance, or federal income-based repayment programs -- which can indicate signs of borrower distress. They also don't include private loans, which account for about 15 percent of the market.

## Little Data

"We didn't realize there was so little data," said Wilbert van der Klaauw, one of the New York Fed economists involved in the analysis.

Studying the growth of education debt as part of total consumer borrowing is important because it may limit access to credit for financing homes or autos, van der Klaauw and economists Donghoon Lee and Andrew Haughwout said in a Jan. 9 interview at the district bank. They and their colleagues also are trying to understand how the rising burden influences living arrangements -- such as college graduates like Roberson who stay with their parents because they can't afford to move out. That, in turn, may reduce marriage and birth rates.

The New York Fed has played an important role in analyzing the potential problem by focusing on outstanding student loans, delinquencies and how this borrowing fits into the larger consumer-debt picture, said Lauren Asher, president of the Institute for College Access & Success, a nonprofit group based in Oakland, California.

## 'No Question'

There's "no question" we need to know more "than the current data tells us," she said.

Students are borrowing more to fund college and graduate school as the cost of higher education rises faster than the rate of inflation. The price tag at some of the most expensive private colleges is

now more than \$60,000 annually. Average tuition and fees at private schools in the 2013-2014 academic year was \$30,094, up from \$18,060 in 2002-2003, according to the College Board, a New York-based nonprofit representing more than 6,000 educational institutions.

The share of 25-year-old Americans with student debt increased to 43 percent in 2012 from 25 percent in 2003, and the average loan balance rose 91 percent, to \$20,326 from \$10,649, New York Fed data show.

## Real-Time Calculations

While the district bank's calculations don't distinguish between private and federal loan debt, they are more real-time than those of the Education Department: They reflect balances on a 5 percent sample of people with a Social Security number and a credit report. The Education Department's default rate covers only dropouts and graduates two and three years after finishing a program.

The department began publishing data on its website in July 2013 about the current status of outstanding federal student loans, such as forbearance and deferment, to provide more information in a user-friendly format, a spokesman said.

There remain a lot of "missing pieces," including the link between debt levels and specific universities or courses of study, van der Klaauw said.

"If you're a pre-med student, you're an engineering student, and you take out \$40,000 or \$60,000 of loans, I have no problem with that," John Silvia, chief economist at Wells Fargo & Co., said in response to audience questions after a speech at the Jan. 10 Raleigh, North Carolina, event. "But if you're going to be a French major, you're going to study social welfare, and you're going to take out \$60,000 of loans, who is making the economic judgment there?"

## Government Loans

U.S. borrowers, including students and their parents, owe \$1.2 trillion in educational-loan debt, according to the Consumer Financial Protection Bureau, or CFPB -- surpassing all other kinds of consumer borrowing except for mortgages. About \$1 trillion is government loans and the rest is an estimate of private loans based on data submitted for a 2012 report.

There's a discrepancy between the CFPB's number and the New York Fed's: The district bank calculates the total at \$1.03 trillion.

"We do hear from borrowers that they sometimes find missing or inaccurate information in their credit reports when it comes to student loans," said Rohit Chopra, the CFPB's student-loan

ombudsman, who published a [blog post](#) in August that analyzed federal debt. "This does raise questions" about the accuracy of information servicers give reporting agencies.

## **Borrow More**

While undergraduates are limited in how much they can finance through federal programs, parents and graduate students can borrow much more. They can take out [federal PLUS loans](#) up to the cost of attendance -- including tuition, room, board, transportation and personal expenses -- minus any aid received.

A student-loan crisis would "force parents and students to think about" their expected return on education, Silvia said. "Like in housing, we learn by going through that craziness, and now hopefully the next generation won't make that same mistake."

Borrowers already have a harder time with repayments. About one in seven, or 14.7 percent, of students defaulted on federal loans in the first three years they are required to make payments, according to Education Department data released in September. The rate was 13.4 percent a year earlier.

While the New York Fed and CFPB data "have their limitations," they are "helping to flesh out the clearer picture and key dynamics," said the Oakland nonprofit's Asher.

## **'More Opaque'**

"Compared to other financial products, performance data on student loans is much more opaque," Chopra said. Given that the market has grown so rapidly, "financial regulators must significantly increase the level of monitoring."

"Our job is to really understand what's happening in the financial system," and the "very rapid rise in student-loan debt over the last few years" can "actually have some pretty significant consequences to the economic outlook," New York Fed President William C. Dudley said at a Nov. 20 briefing with reporters at the district bank.

"People can have trouble with the student-loan debt burden -- unable to buy cars, unable to buy homes -- and so it can really delay the cycle."

Tiffany Roberson now is looking for a third job, partly because rising interest rates have increased her debt to about \$72,000 in federal loans and \$102,000 in private loans. She pays almost \$1,000 a month on the latter and about \$33 on the federal loan through a program based on her income.

“These payments eat up my paycheck,” she said. “It puts a huge drain on living the American dream.”

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# Resetting the Trillion-Dollar Student-Loan Debt Problem

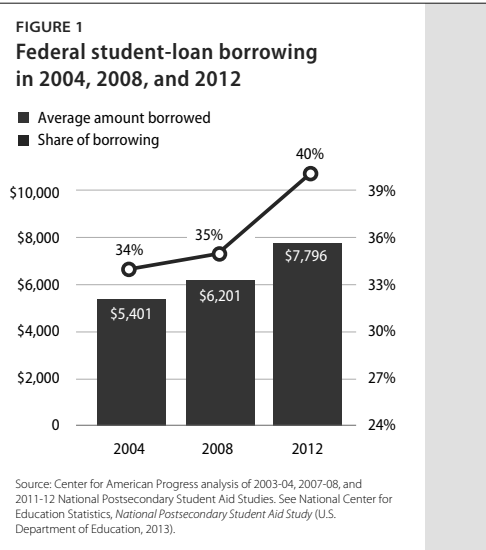
By David A. Bergeron, Elizabeth Baylor, and Joe Valenti November 21, 2013

## Introduction

In ever-increasing numbers, students enrolled in our nation’s colleges and universities are borrowing to meet educational expenses. As college costs rise, so too does the amount each student is borrowing. While federal student loans can be consolidated, these and private loans cannot be refinanced. If refinancing of student loans were available, borrowers could see significantly reduced monthly payments; lenders—including the federal government—could see increased repayment rates; and we all could see more economic activity, as a portion of each student-loan borrower’s income could be spent in other sectors of the economy or saved for larger purchases. In this issue brief, we review a number of proposals pending before Congress and recommend a number of elements that need to be included in a plan to permit student-loan refinancing.

## Student-loan debt in America

Our higher-education financing system has become increasingly dependent on debt. Data from the Department of Education illustrate the precipitous growth of debt over recent years. In the 2011-12 academic year, 40 percent of undergraduates borrowed under federal student-loan programs—an increase of 18 percent since 2004 and 15 percent since 2008. More troubling is the fact that among those borrowing, the average amount borrowed in 2012 was nearly \$7,800, up 44 percent from the 2004 amount of \$5,400 and up 26 percent from the 2008 amount of \$6,200.<sup>1</sup> (see Figure 1) These figures represent just one year of borrowing; total borrowing levels for degree completion are likely to be substantially higher.



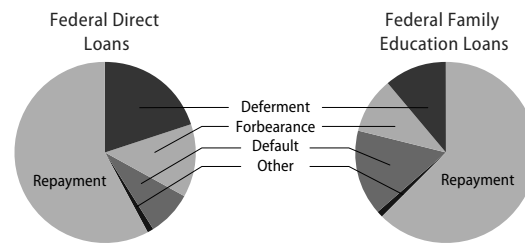
1 Center for American Progress | Resetting the Trillion-Dollar Student-Loan Debt Problem

Consider this: It took 23 years for federal student-loan programs to lend their first \$100 billion. Now, the federal government lends substantially more than that each year, and more than \$1 trillion in federal student loans are outstanding.<sup>2</sup> Of those outstanding loans, only 60 percent of borrowers in repayment were actually making their scheduled payments. The remaining 40 percent were in deferment, forbearance, or default, indicating that the borrowers are in distress.<sup>3</sup> (see Figure 2)

Fluctuations in student interest rates and growing evidence of borrower distress in federal student-loan programs and the portfolios of private loan providers suggest that new and aggressive policy solutions should be enacted, ensuring that repayment terms remain manageable and students are able to make progress in retiring their debt. Allowing students to refinance their loan debt and take advantage of newly established lower rates could reduce the number of students in distress.

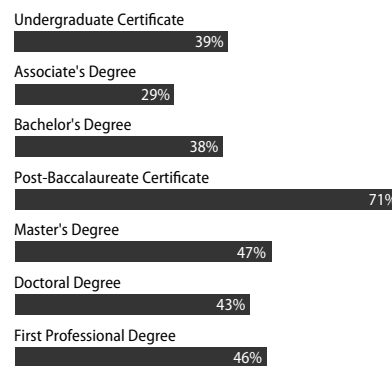
Further data released by the Department of Education provide clear evidence of the difficulty that many graduates are having in repaying their student loans.<sup>4</sup> Repayment rates measure the share of students in a program that are able to make payments on their loans that reduce the principal balance by at least \$1 in a given year. The Department of Education examined 1,930 associate's degree programs at for-profit institutions of higher education and found a median repayment rate of 29 percent. This rate means that fewer than 3 in 10 students were able to make payments that reduced their loan balance and that half of the programs measured at that degree level had an even lower rate. Of 732 for-profit bachelor's degree programs measured, the median repayment rate was 38 percent, while the 4,567 undergraduate certificate programs at all types of postsecondary institutions had a median rate of 39 percent. Graduate degree programs at for-profit institutions had median rates ranging from 43 percent to 47 percent. The program level with the highest median rate—71 percent—was the post-baccalaureate certificate level at all types of postsecondary institutions.<sup>5</sup> (see Figure 3)

FIGURE 2  
Rates of repayment, deferment, forbearance, and default in federal student-loan programs



Source: CAP analysis of U.S. Department of Education data. See Federal Student Aid, "Direct Loan and Federal Family Education Loan Portfolio by Loan Status," available at <http://studentaided.gov/about/data-center/student/portfolio> (last accessed November 2013).

FIGURE 3  
Median repayment rates in programs that lead to gainful employment by degree level



Source: CAP analysis of U.S. Department of Education data. See U.S. Department of Education, "Negotiated Rulemaking 2013 – Gainful Employment Session 1 Materials, Repayment Rate Calculations," available at <http://www2.ed.gov/policy/highered/regs/hearulemaking/2012/gainfulemployment.html> (last accessed November 2013).

The Department of Education also calculated the debt-to-earnings ratios for graduates of programs that must, under the Higher Education Act of 1965, lead to gainful employment in a recognized occupation to ensure that student borrowers earn enough money to support the level of debt needed to pay for their education. The programs are organized by Classification of Instructional Programs, or CIP, codes, which are designed to track fields of study in postsecondary education. An analysis of programs at all levels by CIP code identified five areas in which students had the most trouble achieving earnings that covered their debt. In these areas of study, most programs were unable to pass the bare-minimum threshold that would allow students enrolled in them to continue to be eligible for federal student-aid programs, and even fewer programs had low levels of debt that would allow students to contribute to the economy.

TABLE 1  
Areas of study with the highest debt-to-earnings ratios<sup>6</sup>

CIP code category	Share of programs with a low level of debt	Share of programs that meet the Department of Education threshold
Communications, journalism, and related programs	9 percent	36 percent
Communications technologies and technicians and support services	14 percent	28 percent
Parks, recreation, leisure, and fitness studies	0 percent	11 percent
Personal and culinary services	29 percent	33 percent
Visual and performing arts	11 percent	22 percent

The Federal Reserve Bank of New York has become increasingly concerned about the levels of student-loan debt. In addition to the \$1 trillion in outstanding federal student loans, the bank estimates that more than \$200 billion in private education loans are outstanding. Information from one lender suggests that more than 9 percent of all loans in repayment are delinquent, with 4.6 percent delinquent by more than 90 days. An additional 3.5 percent of loans in repayment are in forbearance, and another 3.4 percent are charge-offs—they have been delinquent for so long that financial institutions no longer expect to collect them and consider them losses. This accounting suggests that more than \$34 billion of outstanding private loans—15.9 percent—are distressed. An analysis by the Consumer Financial Protection Bureau estimated that 7 million people are in default from a federal or private student loan.<sup>7</sup>

As we observed in our report, “A Comprehensive Analysis of the Student-Loan Interest-Rate Changes that Are Being Considered by Congress,”<sup>8</sup> student-loan interest rates have significantly fluctuated in recent years. This fluctuation reflects the changes in the cost of capital and in servicing student-loan debt overtime. In that analysis, we suggested that refinancing options could be provided to permit existing borrowers to move into the new approach to setting interest rates. This would allow borrowers that currently have interest rates as high as 8.25 percent to move down to the newly established rate. We suggested that it would be possible to defray some of the cost of refinancing by assessing

borrowers a one-time fee or charging a slightly higher interest rate, similar to the current consolidation loans. Our recommendation was consistent with a report issued by CAP earlier this year<sup>9</sup> in which we pointed out that homeowners, corporations, and state and local governments<sup>10</sup> were taking advantage of the current historically low interest rates by refinancing their debt.

But student-loan debts are difficult to refinance. In the past, under the bank-based Federal Family Education Loan Program, lenders would occasionally take matters into their own hands, lowering interest rates below the maximum level set by law. Lenders often lowered the interest rates selectively—picking and choosing to which students they gave lower interest rates. The secretary of education had the authority to lower interest rates in order to encourage on-time repayment, but that authority—except as an incentive to encourage the use of Electronic Funds Transfer, or EFT—was eliminated in the Budget Control Act of 2011, making it impossible to address inequities in student-loan interest rates through executive action. Recognizing the severity of student-loan delinquency, federal bank regulators encouraged financial institutions to work with troubled private-loan borrowers.<sup>11</sup>

Last fall, the Consumer Financial Protection Bureau released a report that highlighted the fact that borrowers with private student loans have few repayment options, noting that, “By far, the most common concern communicated by borrowers is the difficulty they have negotiating a repayment plan with their servicer in periods of unemployment, underemployment, or financial hardship.” Borrowers also expressed frustration that there are few “workable” repayment plans or refinancing options available for private loans.<sup>12</sup>

Providing student-loan borrowers the opportunity to refinance their debt is a way to solve a significant portion of the growing student-debt problem. Refinancing could significantly reduce monthly payments, increase repayment rates, and stimulate the economy by freeing up a portion of each student-loan borrower’s income that could be spent in other sectors of the economy or saved for larger purchases.

The Federal Reserve Bank of New York has studied spending patterns and observed that those with student-loan debt are less likely to borrow to buy a home or car. In an April 2013 report, *it concluded that* for the first time in at least 10 years, 30-year-olds with no history of student loans were more likely to have home-secured debt than those with a history of student loans and that by the fourth quarter of 2012, student borrowers were actually less likely to hold auto debt than those with no student-loan debt.

Student-loan debt also holds back the nation’s housing recovery. Two million more adults ages 18 to 34 now live with their parents than before the recession. Each new household formed leads to an estimated \$145,000 of economic activity, according to Moody’s Analytics.<sup>13</sup> Student-loan debt may also be partially responsible for the decline in the national homeownership rate, which recently reached an 18-year low.<sup>14</sup>

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### Addressing the problem

As important as these economic issues are for young adults, addressing the student-loan debt problem could boost trust in government among young Americans. Congress has begun to take note of the problems, with legislators offering four proposals to allow refinancing of existing student debt. Below, we describe these proposals and provide an analysis of each proposal. Taken together, these proposals provide a way forward to meaningfully address the need to reduce the monthly payments of millions of borrowers with existing student loans.

The Responsible Student Loan Solutions Act, proposed by Sen. Jack Reed (D-RI), Sen. Dick Durbin (D-IL) and Rep. John Tierney (D-MA)

Sens. Reed and Durbin and Rep. Tierney take a straightforward approach to addressing the refinancing of federally held or guaranteed student loans. The Responsible Student Loan Solutions Act was primarily designed to reset student-loan interest rates at the 91-day Treasury bill level, with an add-on percentage determined by the secretary of education to cover program administration and borrower benefits. Under the plan, interest rates for need-based, subsidized federal loans would be capped at a maximum of 6.8 percent. Rates for unsubsidized and parent loans would be capped at a maximum of 8.25 percent.<sup>15</sup>

The Responsible Student Loan Solutions Act would also give the secretary of education the authority to reissue federal Stafford and PLUS loans at the same lower interest rate plus a markup for the cost of servicing. Under the bill, administrative costs can equal a maximum of 0.5 percent of the loan principal.

Federal Student Loan Refinancing Act, proposed by Sen. Kirsten Gillibrand (D-NY)

In the Federal Student Loan Refinancing Act, Sen. Gillibrand proposes permitting consolidation of all federal loans—Direct Loans and Federal Family Education Loans, whether held by a bank or the federal government—into a new loan at an interest rate of 4 percent or less. The secretary of education would notify borrowers with only Direct Loans of the consolidation at the lower interest rate within 90 days of enactment. For all other borrowers, the secretary would send a completed application for a consolidation based on information in the National Student Loan Data System within 90 days. The borrower would have six months to return the application for a consolidation loan.<sup>16</sup>

If a borrower is in the process of earning a benefit at the time of consolidation—including through participation in Public Service Loan Forgiveness, reduced monthly payment programs, or other repayment plans—the borrower would remain on track to receive the benefit.

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Student-loan refinancing proposal by Rep. Mark Pocan (D-WI)

In the House of Representatives, Rep. Pocan proposes legislation similar to that of Sen. Gillibrand. This bill, introduced in August 2013, provides refinancing options for student borrowers under the newly variable interest rate that was enacted in the Bipartisan Student Loan Certainty Act of 2013. That law reset the interest annually at the level of the 10-year Treasury note plus an add-on to offset costs associated with running the program; interest rates are capped based on loan type. Rep. Pocan's proposal states that any student with Direct Loans would be allowed to refinance his or her loans to the rate that a new borrower faces at the time of modification. This new rate would be fixed until such time that the borrower chooses to modify his or her loans again.<sup>17</sup>

Refinancing Education Funding to Invest, or REFI, for the Future Act, proposed by Sen. Sherrod Brown (D-OH)

Sen. Brown has proposed legislation that would address the issues specific to private student loans. Under Sen. Brown's REFI for the Future Act, the secretary of the Treasury would have the ability to purchase private loans or participation interests in private loans or provide a liquidity backstop for private student loans. Appropriately structured, these purchases are designed to eliminate inefficiencies in the private student-loan market and accommodate reasonable refinancing opportunities for private student-loan borrowers.<sup>18</sup>

Sen. Brown's bill is modeled after the authority granted in the Ensuring Continued Student Loan Access Act.<sup>19</sup> Under this act, the secretary of education purchased more than \$110 billion in Federal Family Education Loans, or FFELs, over the course of three fiscal years, freeing up capital that could be used to make additional student loans.<sup>20</sup>

If enacted, the REFI for the Future Act would encourage greater competition, innovation, and participation of private capital in a currently stagnant private student-loan refinancing market and create opportunities for private student-loan borrowers to take advantage of the current low interest rates, which will ensure that some borrowers pay rates that reflect their credit risk. By reducing the amount that private student-loan borrowers must pay, this plan can ensure they may pursue economically productive activities such as buying a home or starting a small business.

Streamlining loan information and payment mechanisms

Each of the three pieces of legislation that have been offered addresses a portion of the student-loan consolidation puzzle.

What is needed, however, is a solution that is easy for student-loan borrowers to navigate. Too often, student-loan borrowers do not know what kind of loan they have. While no bank-based FFELs were issued after July 1, 2010, students will still have difficulty determining which are Federal Direct Student Loans, which are FFELs, and which are truly private loans.<sup>21</sup> For this reason, Congress needs to mandate that the secretary of education develop a portal that all student-loan borrowers can use to access information on their loans. This portal would largely be built with information from the National Student Loan Data System, or NSLDS. However, information about private student loans would be needed to augment the information in NSLDS. Requiring lenders to report all private student-loan disbursements to the secretary for inclusion in NSLDS would address this limitation and give policymakers and the public a more complete picture of how student borrowers are faring.

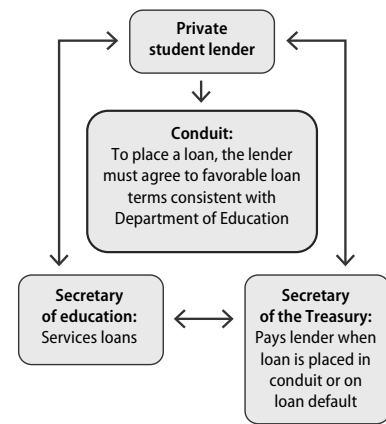
From this portal, each student-loan borrower could be provided with information about the range of consolidation and refinancing options available. In the case of federal student loans, borrowers should be provided the best-possible loan interest rate. In the case of borrowers that took out loans prior to July 1, 2013, if the rate they face is higher than current rates, the interest rate could be written down to the new level plus a small transaction fee.<sup>22</sup> Borrowers that take out student loans under the new statutory formula should have their interest rate reset upon graduation if the interest rate would lower the weighted average of the loans taken out.

In the case of students with a mix of federal and private loans or just private loans, a model similar to that proposed by Sen. Brown seems appropriate. Under this approach, a conduit structure could be created into which lenders could place loans with the interest rate written down to assist borrowers. Loans placed in such a structure would have to have other terms and conditions to make them more like federal loans, such as death and disability insurance protections and the availability of deferments and forbearances and income-based repayment options. Upon a loan's placement in the conduit, the lender would be paid a small percentage of the outstanding amount so that the federal government has a financial interest in the loan.

If a loan placed in the conduit becomes delinquent, the Treasury secretary would buy out the private lender for its remaining interest on the loan. The amount paid for the remaining interest would never be the full value of the loan but would reflect the lender holding a portion of the risk. (see Figure 4)

Such an approach would ensure that lenders are making private student loans with liquidity well beyond what would be available in the current market and provide the federal government with a performing asset if the lender needed to exercise its liquidity option.

FIGURE 4  
Student-loan refinancing structure



In order to provide borrowers with the best possible interest rate, servicing risk needs to be minimized. For this reason, new passive collection mechanisms should be explored. Such a passive system could use the tax withholding system as the default mechanism for collecting student loans. Passive payment could include automatically enrolling eligible students in reduced monthly payment programs, such as Income-Based Repayment, or IBR; or Pay As You Earn, or PAYE—or, more extensively, could use the tax system to automatically deduct income-adjusted student-loan payments from gross earnings. This structure would also significantly reduce the servicing cost, allowing the funds currently used to support the collection system to be used for more constructive purposes such as increasing Pell Grants to reduce student indebtedness.

Permitting refinancing of student loans will lower returns for taxpayers, in the case of federal loans, and for investors, in the case of private loans, in the short term. As the New York Federal Reserve Bank concluded with regard to home mortgages, however, the macroeconomic effects of additional money in student-loan borrowers' pockets will more than offset those losses. As a result, student-loan refinancing will likely not simply be a zero-sum transfer from taxpayers and investors to borrowers. Indeed, the evidence the New York Federal Reserve Bank has developed related to home mortgage loans has direct applicability; we believe, with respect to student loans, it means that borrowers relieved of some interest expenses will spend or invest those savings, stimulating economic growth.

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Conclusion

Given the growing amount of student loans entering repayment, it is critically important to provide refinancing options for student-loan borrowers. An internal analysis<sup>23</sup> by the Center for American Progress estimated that student-loan borrowers who currently face rates greater than 5 percent could save as much as \$14 billion per year, resulting in significantly reduced monthly payments if they are able to refinance their student loans. Additionally, these borrowers likely would spend or save for larger purchases, increasing economic activity overall by as much as \$21 billion. For this reason, it is critical that Congress move quickly to create opportunities for refinancing student loans while the cost of capital remains low.

*David A. Bergeron is the Vice President for Postsecondary Education at the Center for American Progress. Elizabeth Baylor is the Associate Director for Postsecondary Education at the Center. Joe Valenti is the Director of Asset Building at the Center.*

Endnotes

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Center for American Progress



## How Qualified Student Loans Could Protect Borrowers and Taxpayers

By Joe Valenti and David Bergeron

August 20, 2013

Last year slightly more than 1 million Americans filed for bankruptcy, as did about 40,000 businesses.<sup>1</sup> As has been the case since the founding of the country, bankruptcy has been an alternative of last resort for those facing severe economic hardships, such as a business failure or medical crisis, and hoping to make a fresh start.<sup>2</sup> Bankruptcy protection encourages a healthy level of risk taking and boldness by letting citizens know that their mistakes may not permanently cripple them financially.

This is cold comfort, however, for the millions of Americans and their families struggling with student-loan debt. Over the past few decades, student-loan debt has grown dramatically and now exceeds \$1 trillion, including more than \$150 billion in private student loans.<sup>3</sup> Since the late 1970s, however, Congress has gradually made it increasingly difficult to discharge student debts in bankruptcy.<sup>4</sup> Only a small number of bankruptcy cases involving student debt succeed due to a rigorous “undue hardship” provision of the bankruptcy code that generally allows these discharges only under the most extremely dire circumstances. Consider the case of Doug Wallace Jr., a graduate of Eastern Kentucky University, who shortly after finishing college became blind due to complications from diabetes. His blindness meant he was unable to work, and as a result was forced to file for bankruptcy protection. While Wallace’s medical debts were readily discharged, some \$38,000 in student-loan debt remained in limbo.<sup>5</sup> As of September 2012, after six years of legal wrangling, Wallace was waiting for a federal judge to finally determine whether his employment prospects were sufficiently bleak that repaying his student loans would cause an undue hardship, resulting in a discharge of the loans through bankruptcy. He ultimately withdrew his request after reaching an agreement with his lender.<sup>6</sup>

Undue-hardship cases such as Wallace’s can be extremely hard to prove, and judges’ determinations on what financial circumstances can be overcome are inconsistent. The National Consumer Law Center’s Student Loan Borrower Assistance Project points to an example of a couple who successfully discharged student loans after demonstrating an undue hardship. In the cited example, both individuals were employed—one was a teacher’s aide and the other was a teacher working with emotionally disturbed children.

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The couple's joint income was barely above the federal poverty level. In agreeing to discharge their student loans, the court also found that the couple had acted in "good faith"—a key component of the undue-hardship determination—because they had previously asked about the possibility of securing a more affordable repayment plan.<sup>7</sup>

Because the discharge of student-loan debt through a bankruptcy proceeding is an extremely rare and inconsistent option, unlike most other debts, student loans may follow borrowers—students or, in an increasing number of cases, their parents—to the grave and result in wages being garnished, tax refunds being taken, and Social Security checks being seized. Meanwhile, most other financial obligations remain dischargeable, including credit card debt and, in some cases, gambling obligations.<sup>8</sup>

The rationale for treating student loans so differently comes from the fact that most student loans are federally funded or insured and have built-in protections against undue financial hardship, including forbearance, deferments, and income-based repayment plans. Moreover, the dissimilar treatment also derives from a prevalent myth, which took root in the 1970s, that asserts that new graduates, especially doctors and lawyers beginning lucrative careers, would opt to declare bankruptcy instead of paying off their student loans. The thinking was that these borrowers would view the negative impacts of declaring bankruptcy as temporary and not particularly onerous when balanced against the course of a long career. In changing the bankruptcy rules in 1976 to exclude student loans, one member of Congress even argued that allowing student loans to be discharged in bankruptcy would be "specifically designed to encourage fraud."<sup>9</sup>

Furthermore, some lawmakers argued that because young borrowers were devoid of much credit history, the damage bankruptcy typically caused for other borrowers—including reduced access to affordable credit, as well as a negative mark on their credit record that could influence potential landlords and employers for up to 10 years—would not really affect young borrowers, allowing them to launch their careers debt free. Federal policymakers were also particularly concerned because many of these loans were made or insured by the federal government, which left taxpayers holding the bag. Yet an analysis at the time by the General Accounting Office (now the Government Accountability Office, or GAO) found that there were only a small number of delinquent borrowers obtaining discharges—typically low-income students who dropped out of poorly performing institutions and had few career options as a result.<sup>10</sup>

Over the nearly four decades since the bankruptcy rules were changed, much has changed about student loans. For example:

- The federal government disbursed \$6.2 billion in student loans in 1982—the equivalent of \$13.6 billion in 2012 dollars. Thirty years later, in 2012, federal student-loan disbursements totaled \$105 billion, more than seven times their 1982 levels after adjusting for inflation.<sup>11</sup>

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- Student-loan debt has grown significantly—45 percent of all American families now have student loans, including 29 percent of families with household heads who are ages 55 to 64 and 13 percent of families with household heads who are ages 65 to 74.<sup>12</sup>
- The average college senior graduated with more than \$26,000 in student-loan debt in 2011.<sup>13</sup>
- Youth unemployment and underemployment are higher too. Since the beginning of the Great Recession, the unemployment rate for young workers ages 20 to 24 has been about 40 percent to 50 percent higher than 1978 levels.<sup>14</sup> While about one in nine white young adults ages 20 to 24 were unemployed in 2012, one in seven Latinos and one in four African American young adults were unemployed.<sup>15</sup>

The number of bankruptcies has increased significantly, but the barriers to filing for bankruptcy are higher as well. The passage of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 narrowed eligibility for Chapter 7 bankruptcies that ultimately forgive debts based on income and debt ratios and instead encouraged borrowers toward Chapter 13 bankruptcy, which involves writing down debts to meet a court-ordered repayment plan.

Some members of Congress have proposed legislation that would again permit private student loans to be discharged more readily in bankruptcy, effectively making student loans equal to credit card debt. This is a start because there are major concerns with the private loan market, including interest rates as high as 19 percent.<sup>16</sup> But the proposal ignores the reality that not all private loans are bad and not all federal loans are ultimately good for borrowers. Case in point: Federal student loans are available for programs that have very poor employment outcomes. Moreover, not all federal loans have the same borrower protections across loan programs. Income-based repayment options, for example, which take into account a borrower's earnings and ultimately forgive the remaining balance after years of payments, often make it easier for borrowers to meet their living expenses and pay off at least a portion of their student loans. But parents using Parent Loans for Undergraduate Students, or PLUS, loans to borrow for a child's education are generally excluded from using the income-based repayment benefit.

Congress should move to make some student loans dischargeable in bankruptcy. Given the persistent myth of the young borrower declaring bankruptcy at the start of his or her career, it is understandable that no one wants to be seen as opening the floodgates to potential abuse. The way to approach this issue, however, is to establish clear and public standards for what we at the Center for American Progress refer to as Qualified Student Loans, or loans that cannot be easily discharged in bankruptcy, which has been done for other types of financial products as a way to identify safer financial products. Qualified Student Loans would include loans, both federal and private, that have reasonable repayment conditions such as low interest rates and access to favorable forbearance,

deferment, and income-based repayment options. These loans would also be qualified based on the successful track records of the institutions and programs receiving the proceeds as a way to ensure that these are programs that—by virtue of their graduate employment rates—give graduates a reasonable chance to repay. Loans not meeting both standards—borrower-friendly terms and some evidence that graduates, based on their employability, are likely going to be able to repay these loans—would be eligible for discharge in bankruptcy just as credit cards are. Other loans—Qualified Student Loans—would maintain the undue-hardship provision while at the same time benefiting from greater borrower protections.

Switching to a system of Qualified Student Loans would provide new transparency in higher education, demonstrating to students and families whether loans are reasonable. It piggybacks on the U.S. Department of Education’s college scorecard, which provides summary information on college affordability and outcomes.<sup>17</sup> Furthermore, the Qualified Student Loan system encourages more prudent student lending. This issue brief discusses the current state of student loans and the history of bankruptcy protection for student loans before laying out a more detailed plan for how Qualified Student Loans would work.

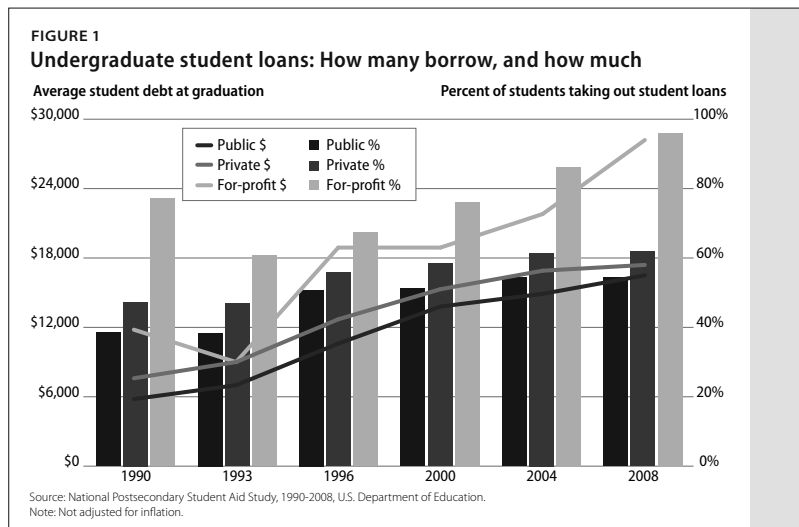
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#### The state of student loans today

For young adults, higher education is an important investment of time and money that is expected to lead to good jobs and higher incomes. Unfortunately, however, for too many individuals the pursuit of higher education increasingly comes with higher amounts of student debt. According to the Federal Reserve Bank of New York, the total amount of student loans outstanding almost tripled between 2005 and 2012, from \$363 billion to \$966 billion, fueled by a 67 percent increase in the number of borrowers and a 58 percent increase in the average balance amount per borrower.<sup>18</sup>

The National Postsecondary Student Aid Study provides an insight into how the patterns of borrowing for undergraduate education have changed over the years. During the 1989-90 academic year, only 39 percent of fourth- and fifth-year undergraduates at public four-year colleges had accumulated student-loan debt.<sup>19</sup> By the 2007-08 academic year, 54 percent of such undergraduates had accumulated student-loan debt.<sup>20</sup> And among fourth- and fifth-year undergraduates at nonpublic institutions during the 2007-08 academic year, 62 percent of undergraduates at private four-year colleges and 96 percent of undergraduates at four-year for-profit colleges took out student loans, compared with 47 percent and 77 percent, respectively, in 1989-90. The cumulative amounts borrowed, on average, also increased during this time period, from \$5,800 to \$16,500 for students at public four-year colleges; from \$7,600 to \$17,400 for students at nonprofit four-year colleges; and most strikingly, from \$11,800 to \$28,200 for students at for-profit four-year colleges.

Even after adjusting for inflation, cumulative student-loan debt increased by 80 percent for students at public institutions between 1990 and 2008, and about 50 percent at both private non-profit institutions and for-profit schools during the same time period.<sup>21</sup> In recent years private student lending has increased dramatically as well, with total debt outstanding more than doubling between 2005 and 2011, from \$56 billion to \$140 billion.<sup>22</sup>



Student loans: How many borrow, and how much do they borrow?

The growing student-debt burden (see Figure 1) particularly affects low-income students, female students, and students of color—groups who are more likely to borrow and typically borrow higher amounts than their more affluent, white, male classmates. Overall, during the 2007-08 academic year, 58 percent of fourth- and fifth-year undergraduates borrowed to meet their postsecondary-education expenses with a cumulative average amount borrowed of slightly less than \$18,000.<sup>23</sup> Those undergraduates attending for-profit institutions were the most likely to borrow—96 percent—and they borrowed the most—\$28,329 on average.<sup>24</sup> African American students were more likely to borrow than other racial or ethnic groups, with 76 percent borrowing an average cumulative amount of \$22,844.<sup>25</sup> Women borrowed somewhat more than men: 61 percent of fourth- and fifth-year undergraduate women borrowed an average of \$18,353, compared to 55 percent of men, who borrowed a cumulative average of \$17,487.<sup>26</sup> Undergraduates majoring in theology or religious vocations were the most likely to borrow—75 percent—but those majoring in computer and information science borrowed the most—\$20,413 on average.<sup>27</sup>

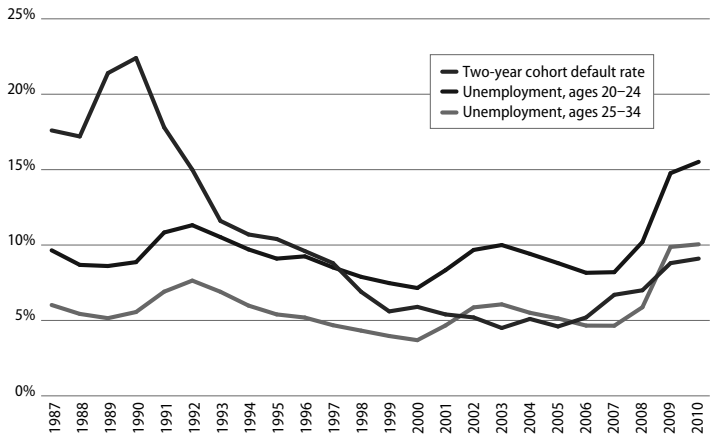
Student-loan delinquencies and unemployment rates

While borrowing has increased, however, the employment prospects of young adults have not kept pace. The unemployment rate of 16.2 percent among Americans ages 16 to 24 is more than twice the unemployment rate for people of all ages.<sup>28</sup> Meanwhile, the unemployment rate in 2010 for young people ages 20 to 24 was more than 15 percent, and it was more than 10 percent for those individuals ages 25 to 34; the rates were twice as high as the unemployment levels for both groups prior to the recession.<sup>29</sup>

Perhaps not surprisingly, young people are increasingly failing to make payments on their student loans. The two-year cohort default rate—a measure of recent graduates failing to make a loan payment for at least 270 days—has increased from 4.6 percent in 2005 to 9.1 percent in 2010.<sup>30</sup> (see Figure 2) The Consumer Financial Protection Bureau recently reported that more than 7 million borrowers are in default on a federal or private student loan.<sup>31</sup> Borrowers in default face serious consequences, including escalating debt levels through the imposition of late fees, interest, and collection costs; losing eligibility for future student aid; a damaged credit rating; and the garnishment of wages and tax refunds.<sup>32</sup> Moreover, nearly one-third of borrowers in repayment are currently delinquent on student debt, meaning that they have not made payments on time—a situation that can also damage a borrower’s credit rating and jeopardize access to other types of loans.<sup>33</sup>

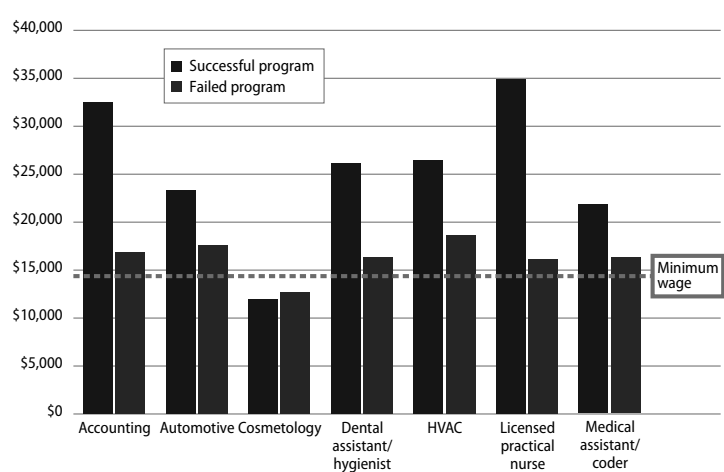
Recent data collected by the U.S. Department of Education reveals that some educational programs that are eligible for student financial aid, including student loans, are ineffective at preparing people for gainful employment in a recognized occupation.<sup>34</sup> Indeed, some programs only provide graduates with the ability to earn minimum wage or would require graduates to contribute a large share of their income above a subsistence level to repay their loans. Some borrowers, ultimately, will be forced into poverty by the very student loan that was intended to help them break out of poverty.

FIGURE 2  
Student loan defaults and unemployment



Sources: U.S. Department of Education; Bureau of Labor Statistics, U.S. Department of Labor.

FIGURE 3  
Annual earnings for program type and success based on discretionary debt-to-earnings ratio



Source: 2011 Gainful Employment Informational Rates, Federal Student Aid, U.S. Department of Education.

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### Average earnings relative to the minimum wage

Increasingly, students are relying on loans to pay for their education at institutions of higher learning. Yet employment outcomes have failed to keep pace with the growing cost of education, leaving some students in a debt trap that can have serious long-term consequences.

Figure 3 shows the average annual earnings for students in different educational programs based on whether a particular program “succeeds” or “fails” at keeping student-debt rates at a reasonable level relative to former students’ salaries. In this case, the measure of success is based on whether debt payments are less than 30 percent of former students’ discretionary incomes—that is to say, income above the federal poverty line. Participants in failing programs may have low earnings that are close to the minimum wage and are comparable to those without degrees despite having invested in education. Income-based repayment options can help, but eligible borrowers need to explicitly choose the alternative repayment programs since they are currently not the default option.<sup>35</sup>

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### The history of student-loan discharge in bankruptcy

There are two main paths to consumer bankruptcy: A consumer’s debts are either discharged in Chapter 7 of the Bankruptcy Code—meaning that the debts may go away if incomes are below a certain threshold and other conditions are met—or debts are restructured into a three-to-five-year repayment plan in Chapter 13 before being discharged, taking into account an individual’s income.<sup>36</sup>

Initially, as part of the Bankruptcy Reform Act of 1978, federally guaranteed student loans could be discharged in a Chapter 7 bankruptcy action only after a five-year waiting period or in cases of undue hardship. Congress passed a law in 1990 extending this waiting period to seven years while at the same time closing the door on restructuring federal student debt in Chapter 13. Two more laws further constrained bankruptcy as an option: As part of the Higher Education Amendments of 1998 the waiting-period option was removed, leaving only undue hardship as a reason for discharge, and in 2005 the same limitations on federal student loans were extended to private student loans as part of the Bankruptcy Abuse Prevention and Consumer Protection Act.<sup>37</sup>

That leaves student-loan borrowers with only the undue-hardship claim, which is not clearly defined. Some, but not all, of the bankruptcy courts have adopted the three-factor Brunner test, which assesses whether the debtor:

- Can maintain, based on current income and expenses, a “minimal” standard of living for the debtor and the debtor’s dependents if forced to repay the student loans

- Has additional circumstances that exist indicating that this current financial situation is likely to persist for a significant portion of the repayment period of the student loans
- Has made good-faith efforts to repay the student loans<sup>38</sup>

Supporters of placing limits on student-loan bankruptcy protection have long argued that students and recent graduates may have stronger incentives to file for bankruptcy at the start of their work lives, knowing that the effects of bankruptcy—including potentially having less access to credit or paying higher interest rates—are temporary over the course of a long career. But evidence that student-loan borrowers would strategically flock to bankruptcy protection remains weak. Indeed, in 1977 the GAO analyzed the bankruptcy filings of borrowers whose student loans were discharged and found that the student loans themselves were generally not the cause.<sup>39</sup> In a random study of bankruptcy discharges of student loans prior to the reforms of the late 1970s, only 8 percent of bankruptcy filers with student loans had no other outstanding debts. Most borrowers had significant unsecured debts other than student loans: On average, student loans were only 29 percent of all debts reported by these bankruptcy filers.<sup>40</sup>

In the early 1990s another GAO review of student-loan performance looked at factors that influence default rates for Stafford loan borrowers. Generally, student-loan borrowers with the highest default risks were often from vulnerable populations. They were frequently low income and/or unemployed, sometimes lacking even a high school diploma, and they may not have actually completed an educational program. Their schools, too, were often poor-quality vocational or trade schools.<sup>41</sup> Given their poor outcomes, they would likely be strong candidates for bankruptcy—if they had access to it.

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How Qualified Student Loans could protect borrowers and allow limited bankruptcy protection

Several bills have been proposed that would once again make bankruptcy protection available to borrowers who have private student loans. In the U.S. Senate, Sen. Richard “Dick” Durbin (D-IL) introduced the Fairness for Struggling Students Act of 2013 (S. 114), and in the House of Representatives, Rep. Steve Cohen (D-TN) introduced the Private Student Loan Bankruptcy Fairness Act of 2013 (H.R. 532).<sup>42</sup> Both bills would reverse the actions Congress took in 2005 when it passed the Bankruptcy Abuse Prevention and Consumer Protection Act, which made private student loans nondischargeable in bankruptcy for the first time unless the borrower could satisfy the same undue-hardship provision as federal student loans. This would be a valuable first step, given the lack of consumer protections for private student loans.

But a bolder approach would be to identify the characteristics of both the student loans and the educational programs that are helpful or harmful to borrowers. Evidence abounds that not all federal student loans are used to support high-quality educational programs—educational experiences that lead to strong employment outcomes. Just as true is the fact that not all private student loans charge high fees and interest rates. Indeed, a number of private student-loan options have no upfront fees and feature fixed interest rates comparable to federal loans.<sup>43</sup> Instead of a one-size-fits-all approach, Congress and regulators could establish definitions for student loans that have a reasonable chance of being repaid—and offer bankruptcy discharges, outside of undue hardship, for loans that do not meet this definition.

To that end, Congress and regulators could establish parameters for a new financial product—what we call a Qualified Student Loan. Such a financial product would need to meet established, reasonable standards regarding affordable interest rates, flexible repayment options, and death and disability protections. It would also need to meet minimum disclosure standards so consumers are able to clearly understand their student-loan burdens when making choices about higher education. Loans meeting these criteria would still be subject to the existing bankruptcy laws that only allow student debt to be discharged in cases of undue hardship. But loans fitting this definition would be available only for institutions of higher education and programs that meet minimum standards in terms of completion, or graduation, rates, job placement, and evidence-based future salary projections—programs that can assure that their graduates have a reasonable chance of repaying their student loans.

These Qualified Student Loan standards would include the following:

- **Reasonable interest rates and fees.** The recently enacted Bipartisan Student Loan Certainty Act of 2013 caps interest rates on federal loans at 8.25 percent for undergraduate students, 9.5 percent for graduate students, and 10.5 percent for PLUS loans, which are also commonly used for graduate programs.<sup>44</sup> Because interest rates moving forward will be pegged to 10-year Treasury rates up to these maximum rates, borrowers this fall face actual rates ranging from 3.9 percent to 6.4 percent.<sup>45</sup> Interest rates in excess of the caps established by Congress make it more likely that a borrower's student-loan repayment will cause an undue economic hardship.
- **Deferment and forbearance provisions similar to today's federal loans.** To help keep student-loan repayment manageable, federal student loans allow borrowers to postpone repayment, though the borrower may need to pay interest in the meantime and loan balances may increase.<sup>46</sup> Lenders are required to grant deferment or forbearance in some circumstances, including for medical and dental school graduates in internship and residency programs and for borrowers active in the military or in national service. Forbearance may also be available in cases of economic hardship.

- **Access to income-based repayment.** The federal student-loan programs offer a range of repayment options beyond the standard 10-year repayment plan, including extended repayment as well as repayment plans that fluctuate based on a borrower's income. Income-based repayment generally involves paying a fixed percentage of one's discretionary monthly income—that is, income above the federal poverty level—toward student loans for 20 or 25 years, with any remaining balance being forgiven at the end of that period. The federal government recently introduced the Pay As You Earn repayment plan, which allows student-loan borrowers taking out loans after 2011 to pay 10 percent of their monthly discretionary income rather than the 15 percent income requirement for student loans prior to 2011. These repayment options provide borrowers with the ability to manage their student-loan debt responsibly, even when their incomes are lower than expected.
- **Reasonable likelihood of repayment.** To be eligible for federal student loans, a borrower must be enrolled in a college or university that is accredited by an agency recognized by the U.S. Department of Education—a mechanism intended to ensure that federal loans only go toward high-quality programs of study. Evidence suggests, however, that some students are able to borrow for educational programs that do not lead to gainful employment in a recognized occupation. In the average medical-assistant or medical-coder program, for example, students would need to devote 84 percent of discretionary income to student-loan payments.<sup>47</sup> As a result, these borrowers are not likely to repay their student loans.

In line with the Obama administration's proposal for measuring gainful employment, several measures may ultimately track whether intended beneficiaries are able to repay. One measure is whether at least 35 percent of an institution's or a program's former students are repaying their loans. Another is whether annual student-loan payments are equal to or below 12 percent of a borrower's total annual earnings, or 30 percent of his or her discretionary income—that is, income above the federal poverty level.<sup>48</sup>

Nonqualified student loans, on the other hand, would not need to meet any of these criteria. These loans, unlike their qualified counterparts, would be dischargeable in Chapter 7 bankruptcy after a specified waiting period—as was the law for federal loans prior to 1998.<sup>49</sup> This would allow for greater flexibility for institutions and students. Institutions would be able to obtain funding for students in programs that have not demonstrated that completers have been successful in entering the workforce. Students could benefit from being able to obtain a loan to attend such a program, without the loan being nearly impossible to discharge through the bankruptcy process—thus transferring some of the risk back to the issuer of the loan—or through some risk-sharing arrangement with the institution offering the program.

Qualified and nonqualified student loans do not necessarily fit in the current divide between federal and private student loans. Some private loans have borrower protections or support programs with a strong repayment history. Some federal loans support weak or high-cost programs even though graduates may not be able to repay their debts. Having a student-loan system that carefully scrutinizes both the loan and the educational institution would provide transparency for borrowers, an exit strategy for the most vulnerable, and strong incentives for institutions and—in the case of private loans, lenders—to improve performance.

Moving toward a system of Qualified Student Loans would have the following advantages:

- **Bankruptcy for those who need it most.** By making private student loans nearly impossible to discharge in bankruptcy, lenders have a strong incentive to make loans to students rather than loans to the general public that could be dischargeable. While this has some benefit, as it brings private capital into higher education, it also provides a powerful incentive to be overly aggressive in making student loans. This has caused some lenders to engage in predatory practices in making student loans. There is an important distinction, however, between productive student debt that is associated with favorable outcomes—in terms of both career growth and repayment—and student debt that may not lead to these preferred outcomes. For the former, the undue-hardship standard may be unduly harsh and in need of reform, but the principle is sound. For the latter, student loans are more akin to consumer debts. It makes no difference whether the loan went toward education or toward the purchase of shoes if it is unproductive debt. Some will argue that this distinction does not go far enough, but it is a valuable starting point.
- **Transparency about borrowing and repayment choices for consumers.** Building off the Department of Education's recently unveiled college scorecard, a Qualified Student Loan definition would fit within the Consumer Financial Protection Bureau's student-outreach mission and its role in promoting improved disclosures across the spectrum of financial products. In addition to clearly explaining student-loan terms and conditions, as well as educational outcomes for the institution, these disclosures can identify whether student loans are qualified or if they are higher-risk loans that would be eligible for bankruptcy discharge.
- **A race to the top for lenders and institutions.** The potential for bankruptcy discharges may steer both lenders and institutions in multiple directions. Some may seek to alter their academic programs or lending structures to neatly fit within the definition of a Qualified Student Loan by ensuring stronger educational outcomes or providing for more flexible repayment plans. Others may accept nonqualified student-loan status, but lenders may require institutions to retain some of the risk for these loans to cover potential bankruptcy losses.

These changes would likely also help address the rate of inflation in higher education by tailoring loans to the amounts that borrowers may reasonably be expected to repay, which in turn could mean that tuition increases are smaller. What's more, institutions may look closer at functions not central to building future employment, and those deemed as not being key to employment outcomes may fall out of favor. Indeed, there may ultimately be effects on higher-education access. Clearly, a Qualified Student Loan system would result in a higher-education system that provides high-quality loans for borrowers in high-quality programs and, for the first time in decades, a reasonable exit strategy through bankruptcy for borrowers whose loan programs may not be up to par.

This approach is consistent with the regulation of other types of financial products. Financial products, similar to other consumer products, should have clear labels that help consumers make smart decisions. Bank accounts and credit-union accounts bear a label from the Federal Deposit Insurance Corporation, or FDIC, or the National Credit Union Administration reminding consumers that their deposits are safe and guaranteed. Meanwhile, investment products will often disclaim that they are “not FDIC insured and may lose value.” Consumers are given a choice and can weigh safety and risk accordingly.

The qualified mortgage rule recently finalized by the Consumer Financial Protection Bureau follows the same dynamic for mortgage lenders, limiting lenders' liability in cases where they follow sound underwriting, document a borrower's ability to repay mortgage loans by pegging them to a maximum percentage of income, and limit fees at closing, among other provisions.<sup>50</sup> Qualified Student Loans would follow this same precedent: defining a loan that is safe for the borrower and has a reasonable chance of being repaid.

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Conclusion

American consumers and businesses have long used bankruptcy as a tool to get out of their most severe debts and get their lives back on track, yet borrowers inundated with student loans have not had access to the same opportunity. The rise in income-based repayment opportunities for federal student loans is a starting point to keep loan payments manageable, but for many borrowers—both federal and private—student-debt burdens may not be readily repaid, leading to dire consequences. Including some student loans in bankruptcy reforms and expanding borrower protections through Qualified Student Loans will ultimately maintain bankruptcy as the narrow path of last resort it was designed to be, while giving those burdened by student debt a chance for a fresh start.

*Joe Valenti is the Director of Asset Building at the Center for American Progress. David Bergeron is the Vice President for Postsecondary Education at the Center.*

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## What Does Value Look Like in Higher Education?



SOURCE: Flickr/lesliebyk

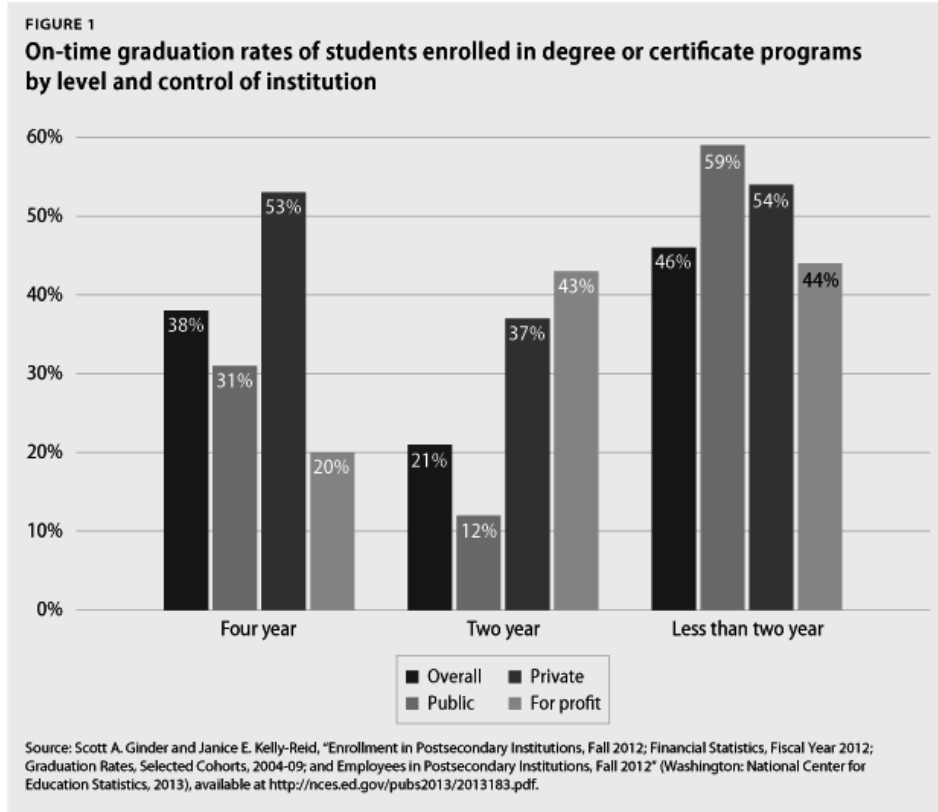
Students and families spend billions of dollars each year to pay tuition and fees at our nation's colleges and universities without understanding the value of the college education for which they are paying.

**By David A. Bergeron | January 29, 2014**

Students and families paid more than \$154 billion in tuition and fees to attend public, private, and for-profit colleges, universities, and trade and technical schools in the 2011-12 academic year, borrowing more than \$106 billion to attend those institutions under the William D. Ford Federal Direct Loan Program. When writing those checks and taking out those loans, few people realize that only 38 percent of students who enter a four-year degree program and 21 percent of students who enter a two-year degree program graduate on time.

To address these issues, President Barack Obama launched the College Scorecard in February 2013. This tool helps prospective students and their families quickly compare institutions of higher education on four key elements: cost, graduation rate, median

amount borrowed, and loan default rate. More recently, he called on the U.S. Department of Education to create a college rating system that identifies institutions that provide the best value for students and families. Consumers could use this rating system as early as the 2015-16 academic year to compare schools with similar missions.



The system would also help identify colleges that do the most to help students from disadvantaged backgrounds, as well as institutions that are improving their performance on this measure. In announcing the rating system, the president stressed that students could continue to choose the college or university they want to attend but offered the possibility that taxpayers might be more generous to students attending high-performing colleges. To tie financial aid to performance, Congress would need to amend the Higher Education Act, or HEA, of 1965 upon its next reauthorization to allow consideration of the college rating system in the awarding of aid. While the creation of a rating system could be accomplished without changes to HEA, using those ratings to change how federal student-aid funds are awarded would require a change to the law.

### The federal government’s plan

Since the president’s announcement, the Department of Education has been holding

public hearings around the country to gather input from students and their parents, state leaders, college presidents, and others on how to develop a rating system that puts a fundamental premium on measuring value while ensuring college access for those with economic or other disadvantages. Inside Higher Ed recently obtained the written comments received by the Department of Education and made them publicly available. Not surprisingly, college and university faculty and administrators have expressed concern that the rating system will include graduates' earnings, which raises the prospect that higher-education institutions will be judged, in significant part, by the earnings of recent graduates.

These critics argue that the true value of higher education comes not from the amount that people are paid but from the significance and meaning of the work that students do for the nation, their communities, or their employers. So judging institutions based in whole or in part on earnings, they argue, would penalize colleges whose graduates go on to do important but low-paying jobs, such as social work or teaching. Overall, the comments received by the Department of Education are consistent with last year's Gallup/Inside Higher Ed poll, which found that most college presidents are skeptical that the rating system will effectively reduce the cost of college. But a change to the quality-assurance system in higher education—whether in the form of ratings or another system—is critically needed and should focus on access, affordability, retention and completion, and post-graduation labor-market outcomes.

With that said, the value of higher education cannot be reduced to a single value, such as the median or average earnings of graduates. As Secretary of Education Arne Duncan has indicated, an assessment of the value of a higher-education institution must include the consideration of a number of factors, including:

- Access: percentage of students receiving Pell Grants
- Affordability: average tuition, scholarships, and loan debt
- Outcomes: graduation and transfer rates, graduate earnings, and advanced degrees of college graduates

Ultimately, the Department of Education will need to refine the measurements used in an alternative quality-assurance system as additional data are developed and institutions work to improve their performance. But critically, aid must focus on providing students with Pell Grants and affordable loans so that they may attend high-performing colleges.

## How schools are currently evaluated

Rating higher-education institutions is not new. Moody's Investor Services rates colleges and universities to assess credit risk in order to help investors, colleges and universities, and other interested parties understand the risks that the U.S. higher-education sector faces. Only a small fraction of all institutions are captured in the Moody's rating system because it is used for a specific purpose, but the notion of placing institutions in broad

categories that reflect their performance against predetermined qualitative and quantitative measures is not new.

A number of media publications, including *U.S. News & World Report*, *The Princeton Review*, and *Washington Monthly*, produce rankings. Each of the ranking systems differs in scope and methodology. As the most well-known publication, *U.S. News & World Report* ranks 1,800 institutions of higher education and recently updated its methodology to reflect the current state of college admissions and better measure student outcomes. *Washington Monthly* includes 1,572 public, private nonprofit, and for-profit colleges and universities, while *The Princeton Review* only includes 378 institutions, which enroll less than 1 percent of all college students.

The current ranking systems, particularly the very popular *U.S. News & World Report* rankings, have changed institutions' behavior in ways that often do not serve students well. For example, *U.S. News & World Report's* use of rejection rates has caused institutions to try to drive up the number of people that apply simply so that schools can reject them. There have also been reports that institutions raise faculty salaries or reduce class sizes simply to move up in the rankings.

The federal government has a long history of providing information about colleges and universities to prospective students. Beginning in the late 1990s, the National Center for Education Statistics, or NCES, made certain Integrated Postsecondary Education Data System information available in a searchable online system called College Opportunities On-Line, or COOL. NCES's current consumer information tool—College Navigator, which provides information about more than 7,500 institutions—replaced COOL in 2007. However, the federal government carefully avoided creating a rating or ranking system until Congress required the Department of Education to make public the rankings of colleges based on the highest and lowest academic-year charges and net price. Those rankings, along with the College Scorecard, are available at the College Affordability and Transparency Center.

### **A new rating system for colleges and universities**

Because the weight of any federal action to create a new accountability system will inherently change behavior, it is critically important to consider how institutions will respond to mitigate any perverse effects. A federal accountability system should operate more like the Moody's rating system than a ranking system, with institutions placed in large categories reflecting performance against key metrics. Among the key metrics that must be included in the accountability system are:

1. Whether the institution provides access to underserved populations
2. Whether the institution is affordable—after the consideration of federal, state, and institutional grants—to students from low- and middle-income families
3. Whether the institution retains and graduates students from low- and middle-income families on time—two years for an associate's degree and four years for a bachelor's degree

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4. Whether graduates successfully go on to graduate school, professional education, or enter the workforce and earn an adequate amount to meet the needs of their families and comfortably repay their student loans, either through service or regular monthly payments

The accountability system should categorize institutions to reflect overall performance against all four measures, with a platinum rating identifying the top-performing schools. Students attending an institution in the platinum category would be eligible to receive additional unsubsidized student loans and more than one Pell Grant in an award year in order to encourage year-round attendance.

Institutions that perform strongly on three of four measures—access, affordability, retention and graduation, and the graduate school, professional school, and employment outcome—would be assigned a gold rating. Students attending institutions with a gold rating would be eligible to receive additional unsubsidized student loans but no additional Pell Grants.

Institutions with acceptable but not strong performance on the metrics would be assigned a silver rating, which would include the vast majority of institutions. Students attending institutions with a silver rating would not be eligible to receive additional unsubsidized student loans or Pell Grants.

Institutions with unacceptable performance on one or more of the metrics would be assigned either a bronze or lead rating. Institutions that provide access and are affordable would be assigned a bronze rating and would not be eligible to receive additional unsubsidized student loans or Pell Grants. As described in greater detail below, the Department of Education could require institutions with a bronze rating to buy bonds supporting a percentage of their students' federal direct loans. Since these institutions provide access and affordability, the focus of federal policy should be to improve their performance on retention, graduation, and the graduate school, professional school, and employment outcomes.

Finally, institutions with poor performance on all measures or that provide access but are not affordable or do not have fair outcomes would be assigned a lead rating. These institutions would ultimately become ineligible to participate in federal student-aid programs if they do not improve. As with the bronze-rated institutions, they would be required to buy bonds supporting a percentage of their students' federal direct loans until they become ineligible to participate in federal student-aid programs.

As conceived, the new accountability system could operate in conjunction with the requirements for institutional and program eligibility to participate in the federal student-aid programs. Currently, a state must authorize higher-education institutions to offer educational programs beyond high school, and an agency recognized by the federal secretary of education must accredit institutions.

Yet a new accountability system based on ratings could be used to establish eligibility to participate in federal programs. In this case, accreditation could be decoupled from the

aid system and become a true community of practice. Such an approach, however, likely would require that some institutions have a stake in the process in order for their students to receive federal student loans. The rating system describes an approach that could require institutions to buy a special class of 10-year Treasury notes with yields equal to the most recent cohort's default rate multiplied by prior-year loan volume. The base yield would be the same as regular 10-year Treasury notes, but institutions with better-than-expected graduation and repayment rates would receive a bonus, and institutions with poorer-than-expected graduation and repayment rates would receive a lower yield.

On January 24, the yield on 10-year Treasury notes was 2.75 percent. Under this proposal, an institution that had a graduation rate that was 10 percent better than expected might receive a yield of 3.025 percent on the notes that they were required to buy, while an institution that had a graduation rate that was 10 percent lower than expected might receive a yield of 2.475 percent.

Higher-education institutions with bronze ratings would be eligible to receive support from the federal government to improve performance from revenues generated by the additional lending under the federal direct loan program to students attending platinum and gold institutions. Like some institutions do today under HEA's current Title III and Title V, the poor-performing institutions would be able to take steps to improve their performance in terms of student graduation and employment outcomes, potentially tied to commitments to meet certain agreed-upon performance expectations. This additional revenue would be put into performance-based funding tied to the agreed-upon outcomes.

The federal government has long supported programs under Titles III and V to help institutions that disproportionately serve low-income and minority students improve academic programs and administrative and fundraising capabilities. These programs have served historically black colleges and universities, tribal colleges and universities, Hispanic-serving institutions, predominantly black institutions, Alaska Native and Native Hawaiian-serving institutions, Native American-serving nontribal institutions, and Asian American and Pacific Islander-serving institutions. But this approach could also provide an alternative and sustainable funding stream that could be devoted specifically to improving the performance outcomes of poor-performing institutions that provide access and affordability to underserved groups.

## **Conclusion**

A new accountability system for postsecondary education institutions that ensures the integrity of federal student-aid programs is long overdue. In the absence of such a system, many students will continue to enroll in institutions with poor outcomes and receive federal student aid to attend those schools. Those most at risk because of inadequate preparation, lack of family support, and other factors will still struggle to complete a degree program and find a job in a rewarding occupation. While a new accountability system will not guarantee every student's success, it will improve the

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odds for our nation's college students and ultimately begin to restore public confidence in the higher-education system by showcasing the best institutions and addressing the very real problem of students and taxpayers paying tens of thousands of dollars to attend institutions with poor outcomes.

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