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CRS Report for Congress

Student Loan Consolidation

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Summary

Title IV of the Higher Education Act (HEA) authorizes the major federal student aid programs, including the guaranteed and direct student loan programs. In FY1996, these loan programs supported an estimated $30 billion in various types of loans; borrowers may simplify their repayments by combining their loans into a consolidation loan. This report describes student loan consolidation, recent problems with the Federal Direct Student Loan Consolidation program, and H.R. 2535 and S. 1294, bills designed to ameliorate the impact of these problems for borrowers. Included in the conference version of the FY1998 Labor, Health and Human Services and Education Appropriations bill, the Emergency Student Loan Consolidation Act was passed and signed by the President November 13, 1997 (P.L. 105-78).

Federal Family Education Loan (FFEL) programs, authorized by Part B of Title IV of the HEA insure and subsidize loans private lenders make to students or their parents to help them meet the costs of postsecondary education. FFELs accounted for about two-thirds of the loan volume in FY1996. Several types of FFELs are available: Federal subsidized Stafford loans (under which the government pays the interest while the borrower is in school, a grace period or deferment); unsubsidized Stafford loans; and Federal PLUS loans (for parents of undergraduate students). Borrowers may simplify the repayment of a number of loans or lower monthly payments by taking out a Federal Consolidation loan, discharging their liability for the original loans. Consolidation loans are repaid over an extended period of time, up to 30 years, depending on the loan amount.

In 1993, a new **Federal Direct Student Loan** (DL) program, authorized under Part D of the HEA, was established; currently, Direct Loans account for slightly more than one-third of total student loan volume. Unlike FFEL, Direct Loans are made by the federal government to students through their schools, thus eliminating the need for private capital. Schools may serve as direct loan originators; alternatively, Direct Loans may be originated as well as serviced by contractors working for the U.S. Department of Education (ED). Loan terms and conditions for Direct Loans are generally similar to those in the FFEL

programs; however, students are provided with additional repayment options, including income contingent repayment.[1]

There are some significant differences between FFEL and DL **consolidation** loans:

- DL program loans are not permitted to be consolidated under FFEL; however, a FFEL borrower, under certain conditions, can apply for a DL consolidation loan, with income contingent repayment terms available.
- FFEL Consolidation Loans have an interest rate that is fixed and equals the weighted average of the rates for the various loans being consolidated rounded up to the nearest whole percent, while DL consolidation loans have the same variable interest rate and caps as Direct Stafford/Ford or Direct PLUS loans.
- FFEL borrowers receive an interest subsidy on their FFEL consolidation loan only if all of the loans consolidated were subsidized FFEL loans; DL borrowers retain the subsidy on that portion of the underlying loans that were subsidized.

In FY1996, FFEL and DL consolidation loan volume was approximately $5 billion.

The ED contracted with Electronic Data Systems (EDS) to perform DL origination functions, including origination of consolidation loans. EDS began loan consolidation operations under the contract in September 1996; however, problems and delays were experienced from the start of operations.[2] On August 25, 1997, ED announced a temporary suspension of DL consolidation loan operations; EDS suspended funding and booking consolidation loans, and stopped accepting new applications. Payments to lenders to book loans have since been resumed, however new applications are not being accepted. At the time of the shutdown, EDS had a backlog of 84,000 applications for consolidation; although they originally estimated that the consolidation process could take 60 to 90 days, some borrowers were experiencing delays of over 6 months; in addition, errors in payoff amounts and promissory notes were occurring.

At a hearing of the House Subcommittee on Postsecondary Education and Lifelong Learning on September 18, acting Deputy Secretary of ED, Mike Smith, testified that the problems were due to the greater than anticipated volume of consolidation loan applications, and an over reliance on automated processes. At the time of the shutdown, EDS had booked 54,000 loans, which is an average of 4,500/month; the contract had estimated volume at 6,000 applications/month; actual volume was closer to 12,000/month.[3] ED testified that it expected EDS to clear out the backlogged applications by December 1, at which time they would resume taking new applications. ED is sending a letter to all those borrowers caught in the process to provide information on their options and to

[1] For further details of the FFEL and DL programs, see: *The Federal Family Education Loan Programs*, CRS Report 94-810, and *The Federal Direct Student Loan Program,* CRS Report 95-110, by Margot A. Schenet.

[2] EDS was originally scheduled to begin the contract in January 1996, but startup was delayed until September 1996 for consolidation and March 1997 for new Direct Loan originations. EDS operation of new loan originations has apparently proceeded without major problems, after the lengthy delay in contract startup.

[3] For
USA Group averages about 3,000 applications/month.

suggest that they request forbearance until their consolidation loan has been booked. Forbearance is the temporary cessation of payments; however, interest would continue to accrue and would be capitalized before payoff.

In an effort to ameliorate the situation for students wishing to consolidate who hold DL or DL and FFEL loans, Representative McKeon and others introduced H.R. 2535 on September 24. On October 1, the House Education and Workforce Committee unanimously reported out H.R. 2535, as amended. Under suspension of the rules, the House passed H.R. 2535, with an amendment, on October 21. This bill would allow loan consolidation under the FFEL program for DL borrowers through October 1, 1998. In addition, FFEL consolidation loans during that time period would carry the same variable interest rate as DL consolidation loans, and borrowers would retain the subsidy on the underlying portion of the consolidation loan that was subsidized. Borrowers could apply to any FFEL lenders for such loans, although lenders are not required to provide them. Language added prior to the bill's passage in the House prohibits lenders from discriminating in making these consolidation loans on the basis of the types of loans, schools attended, interest rates, or repayment schedules. The costs of changing the FFEL consolidation terms and conditions through the end of FY1998, estimated at approximately $25 million, would be offset by reducing the funds in the account authorized by Section 458 of the HEA to pay for DL and some FFEL administrative costs.[4]

Supporters of the bill are skeptical that ED will be able to resolve the DL consolidation backlog by December 1 and argue that this would provide relief for borrowers caught by ED's problems with the DL contractor, allowing them to obtain a FFEL consolidation loan with lower payments, and avoiding financial difficulties or even default. By making this option available as quickly as possible, borrowers would also not be faced with substantial amounts of interest accrued and added to their loan principal. Presumably the long term question of comparable terms and conditions between FFEL and DL will be resolved during HEA reauthorization.[5] Some may argue, however, that congressional action is not needed. Lenders may be reluctant to make these additional consolidation loans (lenders pay an annual rebate fee on consolidation loans, and these loans may carry lower interest rates); the average time to process a FFEL consolidation loan is 30 to 90 days, by which time the ED contractor may be processing DL consolidation loan applications again, which provide borrowers with the additional income contingent repayment option. Finally, offsetting costs from Section 458 may limit ED's ability to administer the two loan programs. The Administration opposes H.R. 2535 as passed by the House because of the use of Section 458 funds to offset costs and because of concerns that lenders will not provide consolidation loans to borrowers with small balances, or who have defaulted on their loans.[6]

[4] Costs are incurred because the government would pay the subsidy benefits on some additional consolidation loans, and would forgo any earnings on consolidation loans that would have been made in the DL program, but are instead made under FFEL. Section 458 funds have already been reduced by $603 million over 5 years under the Balanced Budget Act of 1997.

[5] For details of loan reauthorization issues, see *Student Loan Issues in Reauthorization of the Higher Education Act*, CRS General Distribution Memorandum, by Margot A. Schenet, July 3, 1997.

[6] These and other concerns were raised in a letter from Secretary of Education Riley to Senator Jeffords on October 22, 1997.

Added to the bill during markup is an amendment to the need analysis formula in title IV of the HEA that prevents any negative consequences for taxpayers claiming the new education tax credits when they apply for federal student aid. Without the amendment, the need analysis system in current law would consider those receiving the credit as having greater resources to pay for postsecondary education and thus they would be eligible for less Title IV assistance. The amendment excludes the credit from any consideration in need analysis. The Administration had included these changes in its original proposals for the tax credits, but they were not included in the Taxpayer Relief Act of 1997. [7] If the change is not made at this time, but delayed until reauthorization of the HEA, it will have budget scoring consequences.[8]

Without such a change, families claiming the postsecondary education tax credits might find that their other aid was reduced and thus the amount they paid for postsecondary expenses hadn't really changed. On the other hand, it might be questioned why the Hope and Lifelong Learning tax credits should be treated differently from most other sources of assistance, which are counted in need analysis and reduce the estimate of a family's need for federal Title IV student aid.

On October 9, Senator Jeffords introduced S. 1294, which parallels H.R. 2535, as it was reported by the House Education and Workforce Committee. S. 1294 was referred to the Senate Labor and Human Resources Committee. On October 22, the Committee voted to report out S. 1294, with a substitute offered by Senator Jeffords that replaced the original language of S. 1294 with that in the bill passed by the House on October 21. Although S. 1294 was reported without objection, Senator Kennedy noted the continued concerns of the Administration regarding potential lender discrimination and the source of funds used to offset costs.

The Emergency Student Loan Consolidation Act was added in conference to the final FY1998 Labor, Health and Human Services and Education appropriations bill which was signed into law November 13, 1997 (P.L. 105-78). The provisions are the same as those passed by the House and reported by the Senate with the addition of one section that reaffirms current law provisions of the HEA allowing ED to use guaranty agency reserves returned to the department for expenses for section 458.

[7] For further information on the credits, see: *Tax Benefits for Education in the Budget Reconciliation Legislation*, CRS Report 97-650, by Bob Lyke.

[8] Under budget scoring rules used by the Congressional Budget Office, the change has no estimated costs if made now, but would cost an estimated $120 million if made next year.