



MYTH VS FACT STUDENT LOAN REFORM

February 19, 2010

Myth: The switch to DL represents another government takeover of private industry.

Fact: The government-guarantee program (FFEL) and direct lending are both public-private partnerships – there is no government takeover because both are *already* government programs. The Direct Loan program provides loans to students directly from the Treasury and then administers these loans through competitively-awarded performance-based contracts with private companies. This approach costs taxpayers less than FFEL, a program in which politically-set subsidies are paid to banks to originate and service student loans. Direct Loans are also more reliable for schools and students. Unlike FFEL lenders, the Direct Loan Program has experienced no problems during the credit crunch.

Myth: Switching to DL substantially increases our national debt.

Fact: Whether guaranteed through FFEL or made through Direct Lending, the federal government is taking the risk on all student loans and the loans are on the balance sheet. Direct lending in fact actually reduces the deficit and, over the long term, reduces the federal debt because the government is no longer subsidizing the banks. Estimates from the non-partisan, independent Congressional Budget Office show these unnecessary subsidies to total more than \$87 billion over the next ten years.

Myth: Competition in the student loan program has resulted in better benefits for students.

Fact: Borrower interest rates and benefits are set in federal law, they do not “rise or fall” based on market forces. The Direct Loan program uses private sector competition where it matters most: in the servicing and collection of loans. This is because private companies will get more servicing business if they keep defaults down and keep schools and borrowers satisfied. Therefore, the new servicing contracts provide the companies with a financial incentive to keep defaults and delinquencies at a minimum. The savings will be invested in Pell grants and other steps to help students, leaving them better off than they are today.

Myth: The Direct Loan Program can't handle the increase in volume.

Fact: In a November 2009 report, the Department's independent Inspector General found that the Department and its contractors have the capacity to handle 100% of the anticipated student loan volume. In addition to system readiness, the IG found that the Department has the resources to assist schools in making the transition.

Myth: Direct Loans aren't "cheaper" than FFEL loans.

Fact: In either system, essentially the same loans are made to the same students at the same schools, with the government carrying the risk of default. The main difference is that the government's cost of acquiring the funds to lend is lower than what we have to guarantee to banks to make the same loans. That is the primary reason that the Direct Loans are cheaper: the government's lower cost of borrowing. In addition, the guaranteed loan program is designed around a wasteful and unnecessarily complicated structure that includes many entities—including lenders, guaranty agencies, and the secondary markets, provides subsidies, and often pays them more than is justified. The transition to Direct Loans will create a streamlined system.

Myth: The DL switch will result in thousands of Americans losing their jobs.

Fact: The Department of Education's contract for private sector loan servicing requires that the processing be done in the United States. As a result, we are already seeing thousands of loan servicing jobs that had been sent overseas return to this country. Furthermore, federal loan volume is growing by tens of billions of dollars, increasing the demand for loan servicing—jobs that are guaranteed to remain in America if those loans are made through direct lending rather than FFEL. The future American servicing jobs at stake far outnumber the domestic student loan origination jobs that remain in the faltering student loan industry today. In addition, jobs would be created by the programs funded by the billions of dollars in savings created by the switch to 100% direct lending. For example, financing school construction creates jobs for carpenters, electricians, plumbers and others. Support for innovative education programs helps to employ educators and to improve the productivity of other workers.

Myth: The lender alternative results in equivalent savings.

Fact: Some of the private banking lenders have proposed an approach in which they would originate the loans and then transfer them to the government for a fee of \$75 per loan. The lender would then service the loan under contract with the Department of Education. According to the Congressional Budget Office, this approach would cost \$13 billion more over ten years than direct lending. Again, estimates from the Congressional Budget Office show that Direct Loan savings will total more than \$87 billion over the next ten years. Moreover, the federal government would be paying these lenders a fee – or subsidy – for a job it can do itself more cheaply and efficiently.

Myth: The lender alternative puts students first.

Fact: The lender proposal will save \$13 billion less than the President's plan over ten years. That \$13 billion subsidy of taxpayer money that the industry wants to keep being paid could fund over two million maximum Pell Grants over the next ten years. That is two million more students who could receive the maximum Pell Grant award, enabling them to go to college. The lender proposal would also undermine the performance-based nature of the proposed DL servicing contracts, which call for lenders to receive additional volume for keeping defaults down and customer satisfaction high. Instead of using competition to create incentives for performance, the lender proposal fixes fees based on congressional mandates—continuing to deliver billions of dollars in unnecessary subsidies to banks.

Myth: The President's higher education plan doesn't help the middle class.

Fact: The President's higher education agenda is a plan to reinvigorate and renew America's leadership in higher education through a historic investment in federal financial aid, reforms to the nation's student loan system, and new policies to help America advance toward again leading the world in the proportion of college graduates by 2020. The proposed switch to 100% Direct Lending will not only end wasteful federal subsidies in the student loan industry, it will reduce costs and maximize benefits for students. The expected savings of more than \$87 billion will be reinvested to raise Pell Grants, shore up our community colleges, provide programming that improves college completion, and allows us to dramatically increase the availability of low-cost Perkins loans which are designed to help students with unmet financial need. Apart from SAFRA, the President has recently unveiled a new income-based repayment plan designed to make student loans more affordable for graduates with high debts and low incomes. These repayment plans will encourage and enable graduates to pursue lower-paying but high-demand careers in areas such as teaching, health care and public safety. Students will be able to limit their payments to no more than 10 percent of income. Graduates working in public service will have their student loans forgiven after 10 years of payments, and all other graduates will be required to make no more than 20 years of payments.