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April 16, 2008

The Honorable Edward Kennedy  
Chairman  
Committee on Health, Education, Labor,  
and Pensions  
United States Senate  
Washington, DC 20510

The Honorable Michael B. Enzi  
Ranking Member  
Committee on Health, Education, Labor,  
and Pensions  
United States Senate  
Washington, DC 20510

The Honorable George Miller  
Chairman  
Committee on Education and Labor  
U.S. House of Representatives  
Washington, DC 20515

The Honorable Howard McKeon  
Ranking Member  
Committee on Education and Labor  
U.S. House of Representatives  
Washington, DC 20515

Dear Chairmen Kennedy and Miller and Ranking Members Enzi and McKeon:

On behalf of the American Association of State Colleges and Universities (AASCU) and its more than 400 member institutions and systems, I write to offer comments on the provisions contained in the recently-introduced bills in the Senate and House to address concerns in the student loan markets- *Strengthening Student Aid for All Act* (S. 2815) and *Ensuring Continued Access to Student Loans Act* (H.R. 5715).

***The State of the Student Loan Markets***

While AASCU recognizes the desire to enact legislation to mitigate any potential reduction in access to student loans, we strongly believe that any changes in current law should be focused on students. While no one knows exactly what the prospect is for a “crisis” in the student loan markets, it is clear that the student loan market is shifting. This shifting landscape may require a policy response, such as the changes in law contained in S. 2815 and H.R. 5715. Before enacting these bills, however, AASCU requests careful consideration of several of the provisions, particularly if these changes are in response to a desire to mitigate any potential loss in access to student loans.

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AASCU would also suggest including a triggering event before some of the provisions become operational, as well as legislative language to ensure exhaustion of options before certain provisions are operationalized.

The current situation in the private educational loan market is a cost of funds and a liquidity issue due to the state of the capital markets. There is currently reduced liquidity as loan-based security purchasers are more cautious about less understood financial instruments. As loan providers use better understood, less exotic, financial approaches to acquire and recycle capital, liquidity should be restored in fairly quick order. In the meantime, we are witnessing a shift in the student loan market. The bottom line is that private educational loans, and to a lesser extent participation in the Federal Family Education Loan (FFEL) program, have become less profitable and stable for lenders—particularly for non-banks. While there would be need for legislation to ensure access to federal student loans, it is less clear that legislation is needed to address a naturally shifting market in private educational loans.

AASCU also encourages a clear recognition in any legislative response the difference between access to private educational loans and access to federal educational loans. While it is clear that some lenders—especially non-banks—are deciding to pull out of the private educational loan business, it is less clear—and likely questionable—that students will not have access to federal loans. Federal policy should not only focus on access to federal student loans, but also on minimizing student loan debt as a way to finance a college education.

### ***Reducing Reliance on Student Loans***

Keeping students at the center of any response to shifting loan markets, AASCU's highest priority is the strengthening of the Pell Grant program. **AASCU strongly supports the Senate provision to modify the program to provide a larger dollar increase to the Pell maximum award to those students whose expected family contribution (EFC) calculates to a negative number**—students who demonstrate the most financial need. The extra grant funds provided by this provision will reduce the extent to which lower-income students rely on loans to finance college and will ensure lenders can direct loan capital toward meeting the financial needs of families with higher incomes.

### ***Increasing Federal Unsubsidized Student Loan Limits***

While AASCU understands that the House and Senate have included provisions to increase unsubsidized Stafford annual and aggregate loan limits in order to provide some relief for students who are unable to secure private loans, these increases will cause an unintended result for some students— who would not borrow a private educational loan—to borrow more simply because they can. This unintended effect is contrary to efforts to increase financial literacy and encourage responsible student loan borrowing. In addition, according to a report issued by the American Council on Education (ACE) on private educational loans- **five percent of undergraduates in 2003-04 took out a private**

**educational loan. AASCU does not support increases to aggregate student loan limits and is concerned that increases in loan limits encourages unnecessary debt financing, while irresponsibly shifting to the federal government the responsibility of what should be a shared partnership among the federal government, states, institutions, and students to finance a college education.**

*Ensuring Families Exhaust All Federal Options Before Using Private Loans*

**AASCU strongly supports the implementation of in-school deferment of PLUS loans provided in both the House and Senate bills.** This provision will encourage parents to use PLUS loans as a financing vehicle rather than having their dependent students assume the liability for private loans. Many private education lenders already offer this same benefit and it is appropriate to offer this benefit in the federal PLUS program.

*Authorizing the Department of Education as a Secondary Loan Market of Last Resort*

The proposal for the Department of Education to act as a secondary market for FFEL loans raises several issues. While AASCU supports this provision as a temporary provision, to sunset in 2009, and the Senate requirement for a representative subset of loans to limit federal exposure to selective sales from portfolios, **AASCU further suggests that the provision be made operational only if the capital markets are slow to return to a state of normalcy,** represented by an extended period, such as six to nine months, of abnormal spreads between the LIBOR rates which are reflective of the cost of funds for lenders and commercial paper (CP) rates which are the index for lender yield. At such a point, it would be more appropriate for the Department of Education to be authorized to act as a secondary market to provide sufficient liquidity to participating lenders to continue to make new federal loans to students.

At issue, is the pricing and conditions for the sale of loans by lenders to the Department, which then determines the net cost of the activity to the federal government. **While AASCU supports the provision in the Senate bill to require any subset of loans sold to the Department to be representative of the entire portfolio** to forestall attempts to sell off only risky loans, the bill also fixes the purchase price essentially at par plus a premium equal to the costs of originating the loan. **The requirement for the Secretary to buy loans at par plus a premium, however, is unnecessarily generous and restricts the Secretary's ability to maintain cost neutrality.**

**AASCU, therefore, supports the provision in the House bill providing some desired flexibility in the purchase price of loans** by requiring the Secretary of Education to consult with Treasury to determine the terms of the purchase of loans. This consultation provides the opportunity to pay a fair market price for a portfolio by taking into consideration factors related to the composition of the portfolio such as potential default and loss risk, average loan balances, and anticipated repayment rates for the loans. Further, the House provision, requiring the lender to use the resultant funds in a manner consistent with continued participation in the program is desirable in that the lender

should be expected to reinvest at least the entire proceeds of the funds from the sale to the Department in new federal student loans.

While it appears that borrowers whose notes are bought by the Secretary will benefit from a broader range of repayment plans through this provision, **AASCU suggests further clarification about the impact of the requirement that there be no new promissory note** on providing the full array of repayment options to the student when the Department purchases the loan. In addition, **language in the bill should be clarified regarding the accounting treatment of interest benefits and special allowance payments** for these secondary market loans.

### *Expanding Lender of Last Resort (LLR)*

Resolving liquidity issues should enable loan access for most students in need of student loans. Therefore, **the LLR should be made operational only after it is determined that the implementation of the secondary market provision does not adequately address any continued problems in the student loan market. LLR, as defined in the House and Senate bills should indeed be the last resort.** If the resolution of the liquidity issues enables sufficient access to federal student loans, then LLR may not be necessary.

However, given the nature of the FFEL program, where loan providers intrinsically attempt to optimize profits, a number of providers will “redline” schools where the profile of loans will not contribute to the profit target of the provider. If a significant number of lenders adopt this form of institutional behavior, it may be necessary to implement the LLR provisions.

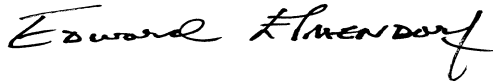
It is understandable there is a desire to provide for institutional designation for LLR eligibility given the nature of loan provider support where business decisions will be made to forgo business relationships with certain schools. However, **AASCU recommends that the institutional designation be made through the use of criteria that clearly demonstrate the lack of access to student loans at an institution.** An example of such criteria would be the denial of a business relationship by lenders that represent at least two-thirds of the loan volume for the prior academic year at the institution. The Secretary should be given the authority to set such criteria for determining whether a school can be designated for LLR participation as an institution rather than the student-by-student basis in current law.

Under the current LLR structure, the Department can advance funds to guaranty agencies to make LLR loans under the FFEL structure. As guaranty agencies make the loans, they receive a fee in lieu of receiving interest benefits and special allowance payments. Loans assigned by the guaranty agencies to the Department offset the advances made to them by the Department. Implementing this model will require the establishment of processes and systems to track this activity.

**AASCU recommends a more streamlined approach to providing loans to students who are affected by market conditions that would trigger LLR.** The guaranty agencies function should be as DL originator and disbursement service agents for schools designated as LLR institutions. In this approach, it would be unnecessary to implement the processes described in the prior paragraph because the functionality in the Common Origination and Disbursement (COD) system used by the Department to process Pell Grants and Direct Loans tracks loan origination activity to control the draw down of federal funds to support disbursements, tracks disbursement activity to substantiate the use of the federal funds, and manages the status of the loans for servicing. This approach provides integrated management of the loan within one administrative structure, rather than a segmented process where ownership of the loan is transferred from the guaranty agency to the Department. This process would also be a better system to control cash management to minimize the float of federal funds to an external agency. Given the nature of COD, even the determination of any negotiated fee to the guaranty agencies for originating the loans, can be automated by determining the appropriate activity status for authorizing the fee payment.

Thank you for your strong leadership in ensuring college is affordable and accessible for students.

Sincerely,

A handwritten signature in black ink, appearing to read "Edward H. Menendez". The signature is fluid and cursive, with a prominent initial "E" and a long, sweeping underline.

Senior Vice President  
Government Relations and Policy Analysis