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The Student Loan Industry's History and Policy Changes

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From their inception, student loans have been a powerful and often necessary tool for allowing middle and low-income families to send their children to college despite the increasing costs of doing so (Collier & Herman, 2016). These loans are highly regulated by the government with policies that have changed over time. These changes have occurred due to the needs of the borrowers and the government officials involved. The concern, however, is that the debt is becoming harder for some borrowers to pay causing defaults and other household burdens (Archuleta, Dale, & Spann 2013).

Most of us in the US are aware that student loans exist but beyond that few really have a good understanding of the student loan industry, how it works, and how it affects borrowers and the economy in this country.

My analysis is designed to shed light on the history of the industry, the current policies in place, and the ways that regulations and changes to regulations affect borrowers. If we can take a good look at the ineffectiveness of some regulations in curtailing the debt boom, there is hope that we will find more effective ways to manage student loan debt. I will be also discussing six key effects causing the higher debt and default rates within the industry:

- The monopoly of having only the Department of Education in charge of disbursing and servicing Federal loan debt leaves no competitive advantages for borrowers
- The ineffective results of the Consumer Financial Protection Bureau which was once under Dodd-Frank and was created to help alleviate decisive practices against consumers including student loan recipients
- The continued lawsuits against government hired servicing companies who claim to have the best interest of the borrower at heart, and yet have allegedly misled borrowers purposely into higher payments and more debt. "The CFPB alleges that, among other allegations, Navient [one of the leading student loan servicing companies] 'systematically and illegally [failed] borrowers at every stage of repayment'..." (Friedman, 2018)
- The lack of information provided to borrowers to make informed decisions about their options
- The higher Federal interest rates on a student loan which do not coincide with the Libor or Prime rates that continue considerably lower than the rates of our student loans
- The drastic increases in tuition costs at both public, private and for-profit schools

Before tackling the problem, it is vital to understand the history of the problem and how we got here. There are many changes we can see that have occurred throughout history that started off with the hope of bridging the gap between high-income families and low-income families with regard to higher education opportunities. According to what I gathered from the research, the government shifted, over time, from grants and scholarships which provided for the good of our society to a loan dominant scheme which relied primarily on student loans.

Keywords: Federal Family Education Loan Program (FFELP or FFEL), Department of Education, Direct Loans, Income-Driven Repayment programs, Higher Education Act,

History

In 1958 The National Defense Education Act (NDEA) was created to encourage Americans to pursue degrees in science and mathematics to offset Russia's advances in space exploration (Mohr, 2017). Because the NDEA worked so well, the government decided to create the Higher Education Act in 1965 (Mohr, 2017). The Higher Education Act expanded the Guaranteed Student Loan program and included Stafford loans to allow poor students to finance their education. As discussed previously, with the start of the Higher Education Act the industry saw loans become more prevalent allowing for lower-income borrowers to also be able to go to school. The different Federal loan options were born to fit the needs of different borrowers. This new program started out under the FFELP (Federal Family Education Loan Program), however, were disbursed in 2007 by the Department of Education (Collier & Herman, 2016). This meant private lenders no longer had the option to fund federal student loans and that all funding for them came from The Treasury. It also meant that student loans debt servicing was the responsibility of the government (Collier & Herman, 2016). The government hired on four main servicers including Navient, Fedloans, Great Lakes and Nelnet to manage billing, repayment and customer service for borrowers.

There is significant importance in understanding the student loan industry to learn the best way to manage student loan debt. There is continued debate about which management options are the most advantageous and the government has gone to great lengths to assist borrowers in obtaining low-cost payment options by adding the new Income-Driven Repayment (IDR) programs. These programs came about due to a public uprising from borrowers defaulting on their student loans or were struggling to make payments. Student loan debt has the strictest rules of any debt, all but excluding bankruptcy, causing some borrowers to default (Mohr, 2017). Consolidation options for borrowers also changed. FFELP (also known as FFEL) programs ended 2007 taking away borrower benefits like 1% rate reductions after so many timely payments. Income-Driven Repayment (payments based on income, family size and other factors) has been filling the gap and allowing those who cannot afford a standard payment to make lower payments. Unfortunately, only 28% of borrowers are taking advantage of these options (Figure 1).

The industry also added forgiveness options to the benefits of Federal loans. The programs started off with just two options: 1. Public Service loan forgiveness for those working for the State, Government or Non-Profit/501 (c)(3) organizations and 2. Income-Based Repayment (IBR) forgiveness for all those borrowers who qualified for income-driven repayment options. If borrowers paid for 25 years under this program the loans would be forgiven (Dobson, 2014). In 2014, the government initiat-

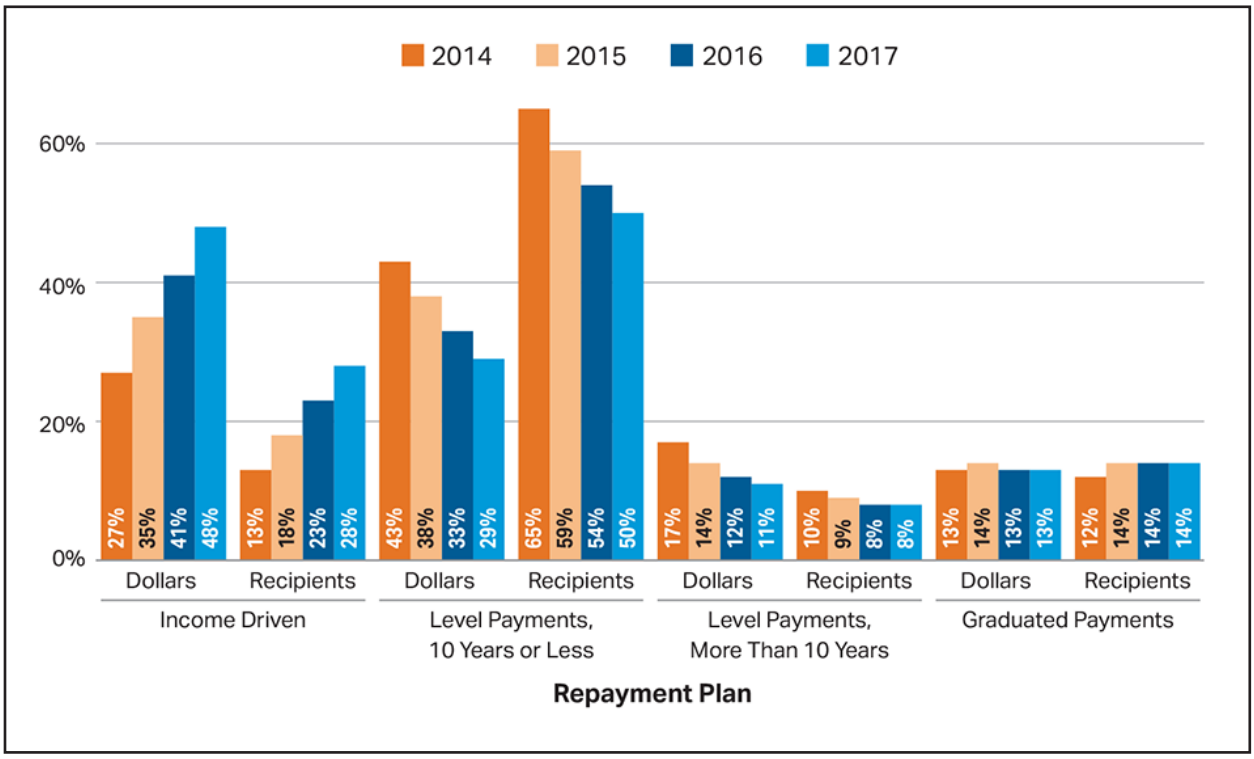

Figure 1: Students taking advantage of repayment options (College Board, n.d.)

ed an additional income-driven repayment option called Pay-as-you-earn (PAYE). PAYE allowed for a borrower's payments to be based on 10% of discretionary income rather than the previous 15% (Dobson, 2016). With this new repayment option came the additional forgiveness option: 3. PAYE forgiveness was added which allowed borrowers to have their loans that qualified for the PAYE payment plan to qualify for forgiveness in 20 years instead of 25 under the IBR forgiveness option.

Types of Student Loans

There are currently Federal and Private Student loans which allow a student or parent of a student to borrow money to cover the cost of higher education.

- Federal Subsidized loans are need-based loans that do not accrue interest while in school, in grace or in deferment
- Federal Unsubsidized loans are not need-based and accrue interest upon disbursement
- Grad Plus Federal loans are loans that are borrowed by those in a Graduate or higher degree program
- Parent Plus Federal loans are loans that are taken out by the parent for their dependent child to cover the cost of tuition, room and board, and other expenses and are the responsibility of the parent
- Perkins Federal loans are disbursed to those with strong needs and are funded by the school at a fixed 5% rate
- HPSL (Health Professional Student Loans) Federal loans are disbursed to those enrolled in qualified health profession programs and show financial need with a fixed 5% rate
- Private loans are disbursed to eligible students and parents based on credit factors with rates generally based on the current Prime or Libor rates along with other qualifying factors

Current Effects of Student Loans on Borrowers

Regulation that should have helped borrowers to reduce their debt load and avoid default seemed to not work. According to Forbes, total student loan debt increased in the 4th quarter of 2016 by 31 billion dollars. New delinquencies also increased by 32.6 billion dollars in borrowers who were 30+ days delinquent and 31 billion by borrowers who were 90+ days delinquent (Friedman, 2018). The government owns and collects on student loan debt (see Figure 2) and therefore has "autonomy in creating new repayment plans" (Collier & Herman, 2016). Fixed payment options are rigid and don't consider the societal or personal economic circumstances of a borrower while income-based programs are extremely under-utilized (Collier & Herman, 2016).

Student loan debt drastically affects students and graduates. The debt has tripled from 2004 to 2012 and has increased even more from 2012 until now (Johnson et al., 2016). Tuition rose 55% from 2004 to 2012. This left graduates with reduced spending power and fewer funds to put towards retirement. It also hindered them from purchasing homes. Student loans have become the top debt, second only to mortgages (Johnson et al., 2016). Some interest rates for student loans are at 6.8%, 7.9%, and even

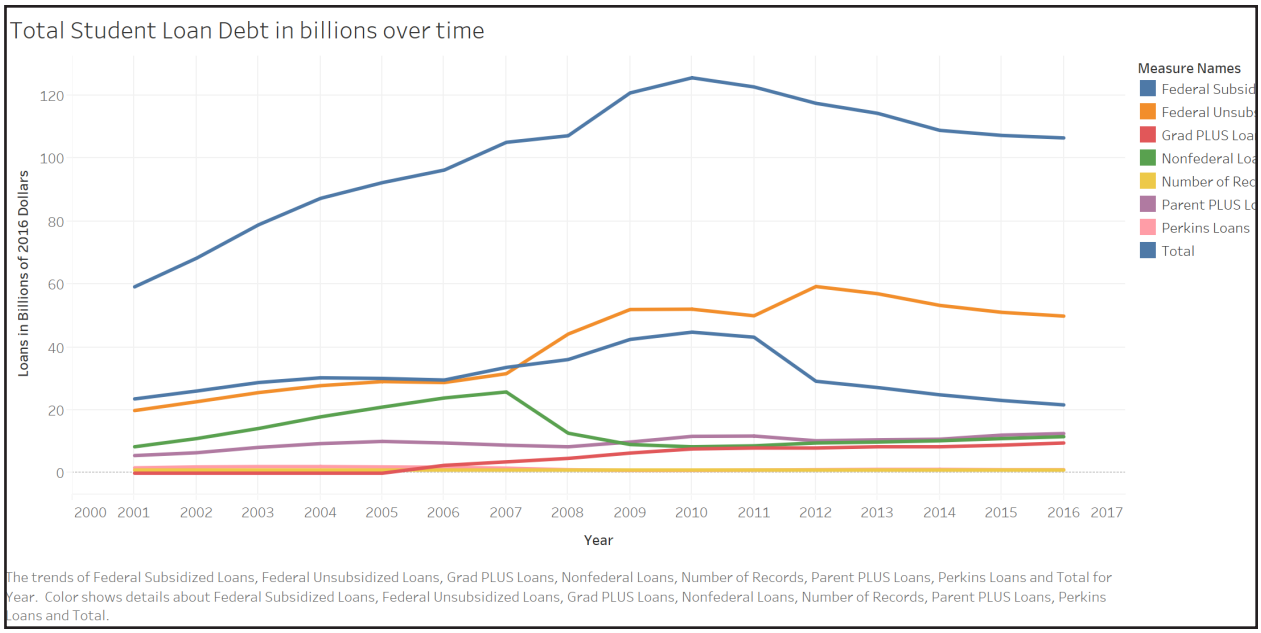

Figure 2: Trends in federally subsidized student loans

8% compared to low mortgage and car loans averaging closer to 4%. To explain further, private lenders once were allowed by the Federal government to consolidate borrowers' federal student loans under the FFEL program. Although the loans had to be consolidated based on the LIBOR rates at that time, these lenders had the ability to offer borrower benefits to clients that signed up to use their consolidation company versus competitors. This advantage, when fully utilized, saved the borrowers massive amounts overall.

Borrowers struggling with high payments also struggle with financial crises within the household, credit issues, and long-term negative repercussions. As we recall the giant mortgage bubble that burst due to highly inflated costs with borrowers who could not afford to pay their loans, we can see the similarities in the student loan industry and the possibility of a similar crisis. Fox Business discusses how Sheila Bair, the Washington College President and former chair for the Federal Deposit Insurance Corp (FDIC), stated student loan debt could certainly be the "next financial crisis" (Fernandez, 2017).

Much more thorough research is needed to delve into the different policies that are currently in place and how they could effectively assist students in gaining their degree without a large debt burden. Over the last 10 years, we have begun to see many people asking the question, "Is college tuition worth the cost?" (Gorey, 2016). Based on Gorey's research, there is a decrease of borrowers still having outstanding loans who have gained mortgages. Researchers and borrowers alike state this is partly due to the cost of their student loans. 71% of student loan borrowers who don't own a home attribute it to having student loans (Gorey, 2016). They also tend to marry and have kids later in life. Those who are overwhelmed with student loan payments and are making large monthly payments are not able to buy homes or other items or may have to put off buying them for several years. "For every 10 percent in student loan debt a person holds, their chance of home ownership drops 1 to 2 percentage points during their first five years after school, according to the Federal Reserve" (Nova, 2018). If loans were disbursed by private lenders and were competitive, we could see much lower interest rates and, in turn, lower payments. These lower payments could allow borrowers to have an easier time paying back their debt and avoiding default. This begs the question of how we can sustain the path we are on if we are unable to even buy a home, which remains the best way to generate wealth. "Owning a home, the most common way Americans build wealth, can become a distant dream for many crushed by student debt" (Nova, 2018). Figure 3 shows that as student loan debt peaked there was a subsequent decrease in mortgages. This could be due to several factors including the economic crash, but we should consider the possibility of a correlation between an increase in student loan debt and a decrease in mortgage debt.

Methodology

Information was gathered from academic journals including ProQuest, Times Digital Archive, Gale and other popular sources. Secondary resources such as College Board, a compilation of government data on funded student loans, was also used for statistical data.

The article was based on an interpretive review on presently available research. I was able to interpret available research based on my over 14 years of experience gained in the student loan industry.

The Industry

The Student loan industry is a very complex and convoluted industry that changes as policies and procedures are updated. When discussing this industry, it's important to understand that we are specifically discussing the inner workings of student loan debt within the United States as other countries have very different rules and regulations on student loans and how they are managed by their respective governments. Also to be considered is that there are different types of Student loans that we will be discussing. These can be broken into the two main segments of Federal Student Loans and Private Student Loans with additional types of loans within those two segments.

Once the Higher Education Act of 1965 was developed, U.S. citizens gained access to what are called Stafford Federal loans (Mohr, 2017). These include Subsidized and Unsubsidized loans. Subsidized loans are loans that do not accrue interest while a borrower is still in school, while in a grace period or during a deferment. Meanwhile, an Unsubsidized loan accrues no matter what once the loan is disbursed. The other difference in qualifications between the two is that Subsidized loans are need-based and can only be disbursed to those who qualify based on income and other factors. In 1992 the Federal Family Education Loan program (FFEL or FFELP) was born and with it added loan options including Federal Perkins loans, Federal Direct Loans, and Federal Family Plus loans. The addition of these loans allowed for middle and low-income families to have better opportunities regarding higher education (Mohr, 2017).

There are also Private loan options. These options require borrowers to have a good to excellent credit score and a reasonable debt to income ratio which

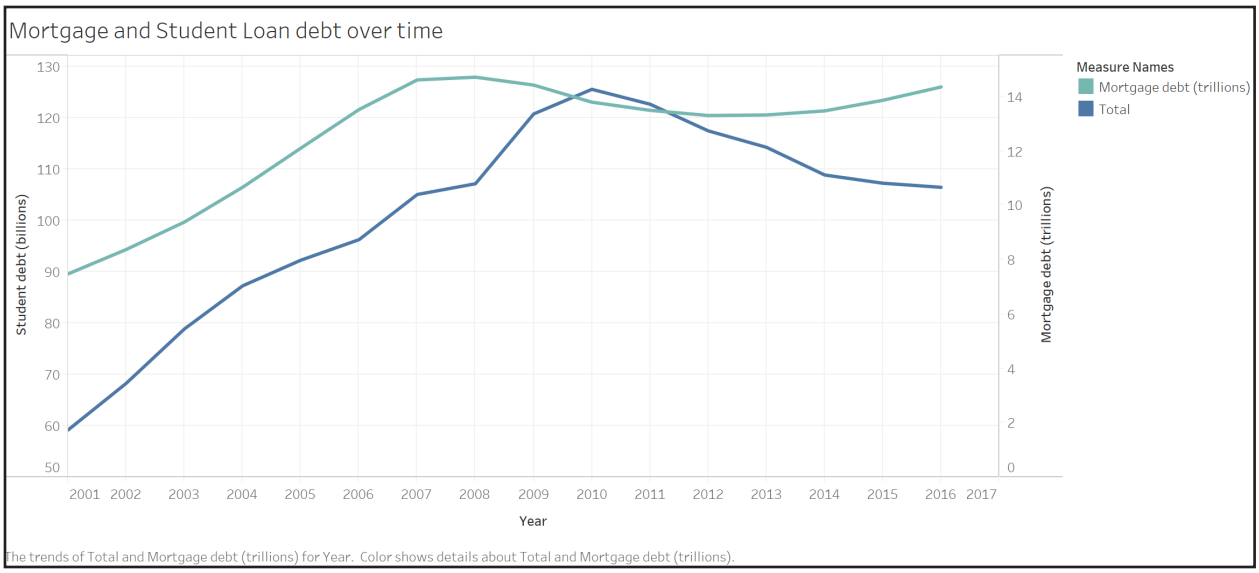

Figure 3: Student loan and mortgage debt

entails debt that is generally only about 30% of the total income they have. They can have a co-signer who meets those qualifications if they do not. The Private loans are an integral part of the student loan industry and do weigh into the debt burden but will not be discussed heavily in this analysis due to fewer regulations and repayment options. Instead, we will stick to federal loan options and regulations and the policy changes that have brought us to the current state of affairs in the industry. Private loans do not have the same stringent regulations nor the same repayment options as the Income-Driven Repayment Plans available with Federal loans. Private loans are not disbursed by the federal government and only makeup about 11% of the total outstanding student loan debt (College Board, n.d.).

Stakeholders

The stakeholders include:

- Students (Former and Future)
- Colleges, Universities, and Technical Schools
- Employers
- Lenders
- Guarantor agencies
- Taxpayers (Lux, 2017)

The only real competitors of the industry are cash paying clients using savings, 539 plans, or other forms of cash payments and those receiving tuition payments or reimbursement from their employers. The suppliers who fund the industry are The Treasury for Federal loans and private lenders for private student loans. The industry is regulated under The Organization of the Bureau of Consumer Financial Protection (formerly known as CFPB) which was created under Dodd-Frank.

Analysis

Consolidation Changes

When consolidations occurred in 2005 under the FFEL program, we saw interest rates at about 2.875% and borrowers received 1% rate decreases after so many timely payments and .25% decreases for setting up automatic payment withdrawal (ACH). This allowed many to see rates at 1.625% making paying back the debt much more affordable. Prior to the regulations changes under The College Cost and Reduction act of 2007, banks had the ability to offer competitive additional benefits to borrowers to consolidate with them. However, with FFEL options gone, most borrowers saw rates averaging closer to 6% and could only get a .25% reduction for ACH despite the LIBOR rates being at an all-time low. The only option for consolidation was under the Direct Loan program (Department of Education). This is assuming a Federal consolidation. Private consolidations were still an option, but they are only available to those with excellent credit, a reasonable debt to income ratio and a degree from an eligible school determined by the lender. Imagine, however, if we kept the Income-Driven Repayment options for Federal loans but also brought back the FFEL options, allowing lenders to offer competitive borrower benefits once again. It can surely be conceived that this would alleviate much of the cost of student loan debt to borrowers.

Roles of Colleges and Universities

When analyzing the industry, we cannot forget about the role colleges and universities play in the increased cost of student loan debt. The research is not conclusive on whether tuition growth aids in the

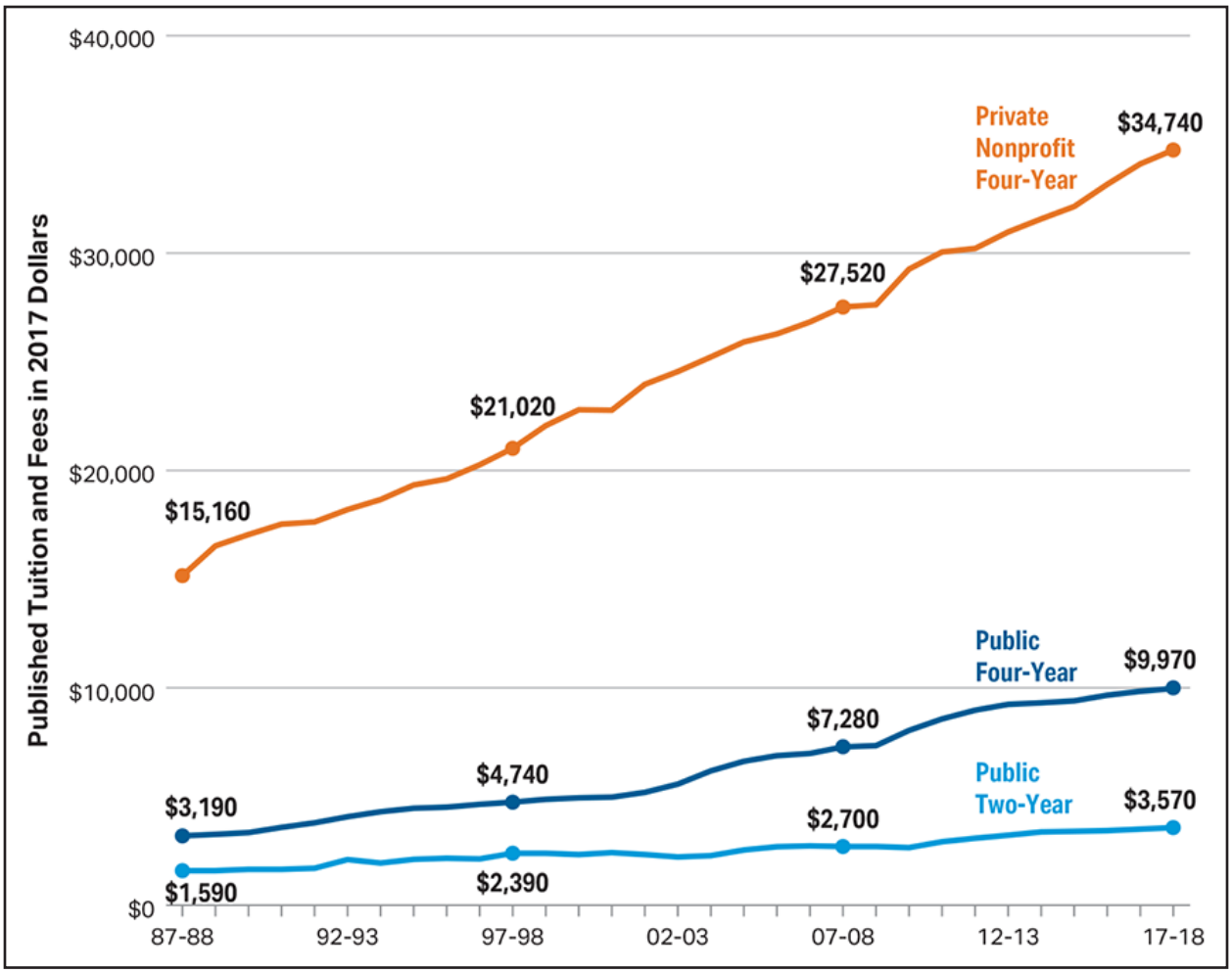

Figure 4: Student loan debt over time (College Board, n.d.)

increase in student loan growth or if the easy access to student loans propels the growth in tuition (Collier & Herman, 2016). Either way, it's clear that the cost of tuition has risen over time. This can especially be seen in for-profit schools as shown in Figure 4.

Some research suggests that the original dismissal of the FFEL program was to cut the cost to the government since these lenders who were offering the borrower benefits were paid by the Department of Education. The government felt they could lower cost by taking over the process themselves. However, based on the research available there is no evidence of savings. The government ended up paying more due to the cost of hiring people and creating processes to confirm and adjust payments under the new program (Collier & Herman, 2016).

The Literature Review reveals a consensus that Student loan debt is not only a big problem, but is quickly growing each day into a much bigger problem. Some researchers have viewed and analyzed the statistics showing the growth of student loans over the last century while other research tried to pinpoint the problem. There was limited research to discuss ways to effectively mitigate the problem but there were numerous articles explaining the burden of debt on borrowers, repayment options and concerns over regulations and future implications. In my opinion, the researchers had a limited scope of the problem due to their limited understanding of the ways in which the regulations affect borrowers and how the policies work in practice.

Conclusions based on the Literature Review

Specific findings of the literature review are summarized in Tables 1, 2 and 3. In a broad sense:

1. There seemed to be no agreement as to why the debt has gotten so high or how to fix the problem.
2. Most of the journals were weak in their ability to explain student loan debt regulations in their totality. Each seemed to come from a different perspective without having enough expertise on the subject.

Table 1: Understanding How Student Debt Works/Current Policies/Effects

Concepts	Components	Reference
Student loan finance	• Multiple loan terms available • Deferment and forbearance to put off payments • Private loan consolidation options • Different federal loan types and regulations • Private debt	(Johnston & Roten, 2015) (Rall, 2015) (Amromin & Eberly, 2016) (Nica & Mirica, 2017)
Income-based repayment Forgiveness Stress linked to loan debt	• Benefits to Income-Based options • Explanation of forgiveness options • Belief Forgiveness is a negative long-term impact • Anxiety major effect of debt • Moderate association of debt to mental health problems • Worried, guilty, anxious and nervous	(Johnston & Roten, 2015) (J. Best & E. Best, 2016) (Archuleta, Dale, & Spann, 2013)
BAPCPA Limited private bankruptcy Effects on Retirement ability	• Bankruptcy abuse prevention and consumer protection act • No decrease in cost given for the inability to file bankruptcy • Defining undue hardship • Tax code changes needed • Retirement savings reduced by 31 cents for every dollar in student loan debt	(Nica & Mirica, 2017) (Grant, 2011) (Johnson et al., 2016)

Table 2: Factors that have Led and Contribute to Current Debt Burden

Factor	Statistics	Reference
FFELP loans go away	• Shift in Higher Education Act • The gap between COA and aid available increases • Financial incentives change	(Grant, 2011)
Change in Student loan Bankruptcy rules Increase in College cost	• The non-discharge ability of loans • Private Student Loan Debt Swap Act • Tuition costs rose 55% • Debt tripled from 2004 to 2012 • State funding decreased	(Grant, 2011) (Johnson et al., 2016)
Borrowers unaware of debt owed For-Profit schools	• 15% of borrowers unaware of the amount borrowed • For-profit borrowers more at risk of default	(Nica & Mirica, 2017) (J. Best & E. Best, 2016)

Table 3: Policy Changes that would Mitigate the Increase in Student Loan Debt and the Burden on Borrowers

General Factors	Specific Cause	Reference
Remove For-Profit schools	• **Small graduating class**	**(J. Best & E. Best, 2016)**
Colleges held accountable	• **A smaller amount of debt but a higher default** • **Lower income/lower job placement** • **2 years of free community college could reduce risk** • **Education level correlated with debt amounts**	
Better Bankruptcy options	• **No rate benefits to no bankruptcy options** • **Change in "undue hardship" code needed**	**(Nica & Mirica, 2017)** **(Grant, 2011)**
Increase in loan repayment awareness needed	• **Too many borrowers unaware of balances** • **Most borrowers don't understand payment options** • **Deferment and Forbearance options could be utilized before the default**	**(Nica & Mirica, 2017)** **(Johnson et al., 2016)** **(Rall, 2015)**
Private (FFELP) lenders	• **Without FFELP lenders the federal government had no reason to provide competitive rates** • **There was a shift to more private loans** • **Private loan considerations changed**	**(Grant, 2011)** **(Rall, 2015)**
Increase online awareness of options	• **Lack of awareness of debt and options could be mitigated**	**(Johnson et al., 2016)**
Income-Based Repayment plan options	• **Repayment plans proved beneficial to borrowers** • **Excess debt should not be a problem with IBR plans available**	**(Johnsten and Roten 2015)**

3. No one seemed to be able to explain the reason for the regulation changes to remove private lenders or even acknowledge them as a major problem.
4. I was surprised by the lack of financial records comparing the previous regulations to the current regulations and correlating these changes to rising costs.
5. It is understood in the research that the cost of education has risen, exacerbating the problem significantly.

Discussion

There is vast research showing several views on the current state of the student loan industry and how to manage student loan debt effectively. When reviewing the findings from Weinberg and Congress of the U.S. (2006) it seems fitting they felt consolidation to be a good option, but you must be cautious of the bias of their findings due to the millions the government makes in interest and origination fees on consolidation loans and the effect this debt has on other industries (Collier & Herman, 2016). Also, the information is somewhat outdated as many changes to consolidation, interest rates, and repayment options have occurred since 2006 when their findings were published. Borrower Student Loan Refi (2016) article spoke on the need to be cautious of consolidations which they outlined in their article. Specifically, they warned borrowers of consolidating their federal loans into private loans. They explained how this would cause borrowers to lose out on federal benefits like Income-Driven Repayment and

Forgiveness options. Most authors who discussed the Income-Driven Repayment programs agree that these programs provide relief for those in need (Collier & Herman, 2016).

Asher, Cheng, & Thompson (2014) produced a very detailed white paper discussing the pros and cons of implementing a mandatory Income-Driven Repayment Plan system. This could be quite beneficial to low-income borrowers, especially if forgiveness options are still available for those who qualify. However, for those who have a higher income who are forced to enter the IDR payment program this plan could end up forcing them to make higher monthly payments along with potentially paying more in overall interest. Despite some concerns, the results of this research could a prove useful guide when implementing a more universally advantageous system in the future.

Collier and Herman (2016) also suggested a plan similar to Asher's. Rather than putting students in a standard repayment first, once they enter repayment status, they would be automatically entered in an income-based repayment plan if they qualified. This would reduce the number of borrowers who default in the early stages of their repayment. They also suggested ridding the loan program of unsubsidized loans and making subsidized loans the primary loan available for undergrad and graduate students (since 2012 graduate students no longer qualify to receive subsidized loans regardless of financial need). Their third suggestion was to ease up on the bankruptcy regulations to allow those who truly need it to gain a fresh start. Finally, they suggest loans be done away with altogether and get back to grant and scholarships as being the primary funding source for education. They believe the government could find money in different areas allowing them to increase the budget for grants and alleviate the burden on students and borrowers (Collier & Herman, 2016).

Conclusions

This industry analysis shows the transition within the student loan industry from the beginning of the program's inception to the present day. The analysis also explains the different types of loans and different regulations fueling the federal student loan industry. Many researchers studying the student loan industry and its various programs have different views on some of the causes of the high debt burden and default rates. They also have different suggestions for possible solutions to mitigate the problem.

A bill called "The Prosper Act" is up for proposal to change the current regulations but there is no word on a vote at this time (Josuweit, 2018). The changes proposed include:

- No more subsidized loans (not even for those in need)
- No lump disbursements to students but rather weekly or monthly like a paycheck
- Only one loan available called "Federal One" loan with the following caps:
- Dependent Undergrads- $39,000 Lifetime Cap
- Independent Undergrads- $60,250 Lifetime Cap
- Graduate Students- $28,500 per year and $150,000 Lifetime Cap
- Parent- $12,500 per child per year and $56,250 per child Lifetime Cap
- PSLF (public service loan forgiveness) would be removed completely

Income-Driven Repayment options would be structured down to one option with your payment being based on your discretionary income, a minimum of $25 paid per month and only the excess interest beyond a standard 10-year term being paid off. This would mean no forgiveness options would be available and your original balance would have to be paid.

With there being so many different plan options, many borrowers don't know which option is best for them.

As Ostrowki (2015) discussed, there is a need for easier paths for borrowers who qualify to have their loans put into one of the repayment plans. With there being so many different plan options, many borrowers don't know which option is best for them. The new Prosper Act would streamline this process by only having one income-based repayment option and one type of loan. However, with no subsidized loans (loans that do not accrue interest during school, grace or deferment) the cost of loans for borrowers who have a high financial need would rise. As the year goes on it will be interesting to see the direction the government takes with new regulation changes. The hope is they gather more research to determine the long-term effects of those potential regulation changes on borrowers and the community to make a decision that alleviates the debt load and burden.

Future Research

I believe there is a strong correlation between the increase in student loan debt and negative effects on the economy. Long term, at the current balance of 1.5 trillion dollars in debt, the cost will drastically affect buying power for borrowers in the future. There needs to be much more research addressing this issue and pointing to the expected result it will

have on everyone (not just borrowers that took out student loans). I was intrigued by the suggestion found in some of the research that we may be looking at the problem wrong when concluding that the cost of loan debt is a problem. One researcher felt it was those who dropped out of school and had a low socio-economic status that caused the brunt of the problem. It poses an interesting perspective on how we may mitigate the problem of defaulted loans. Another article even went so far as to assert that student loan debt isn't really a problem at all.

Additional research should be conducted to pinpoint how student loan debt has gotten to such an astounding amount and what we can do to slow down the rise in the debt burden. We must also analyze in more detail who may be at fault. Is it the government and the policies that have been created or the colleges and universities that should be blamed for high tuition costs forcing students to borrow more? It will be important to also analyze borrowers who take out the debt and determine in more detail why they do not pay back the debt and how, if at all, they can be nudged to do so more effectively.

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Review

This article was accepted under the ***constructive peer review*** option. For futher details, see the descriptions at:

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