Student Loan Program Changes

Monday, 14 July 2008

With the passing of multiple student loan related bills (1, 2) in Congress, there are many changes to the program that begin this year. The student loan industry has come under intense scrutiny over the last few years, as investigations have found several instances of conflicts of interest among lenders, universities and the Department of Education. The new laws and regulations will help restore balance to the student loan system by reducing unnecessary lender subsidies. This article highlights some of these major changes in the student loan industry and how they affect both current and future college students.

In 2007, Congress cut almost $20 billion in federal subsidies to lenders that provide government-backed student loans and applied most of that money toward increasing the amount of financial aid available to students of lower-income families. Because of the recent legislation and the current environment of the student loan industry, student loans have become far less profitable for lenders providing student loans.

Many lenders have exited the student loan business entirely, viewing it as unprofitable given the current circumstances. Now, what college you attend may decide whether or not you get approved for a student loan. Some of the largest lenders have even stopped providing student loans to students at community colleges, for-profit universities and other less competitive colleges, even as they continue to lend to students at the nation’s top universities. Many lenders will also stop making loans at schools where the loans are not profitable or the loan amounts are too small.

Students attending elite, expensive, public and private four-year universities will still be guaranteed access to student loans. The banks view these (usually larger) loans as more profitable and have less risk to the lender, in part perhaps because the universities’ graduates usually earn more and students from these schools typically have a lower default rate.

Lenders base their lending decisions on analysis of which colleges have higher default rates, low number of borrowers and small loan amounts that make it less profitable. To cut off funding for students just because of a small profit margin is totally unethical, which is why many believe the whole system needs an overhaul. In response, senators recently issued a bill that would prohibit lenders from picking and choosing among colleges and students. Those in the federal loan program would have to provide loans to any eligible student, regardless of income, grade level, and where the student attends college. This ensures those students who come from lower income families are offered the financial aid they need to pay for college. When lenders are able to pick and choose among students, those from lower income families may get bypassed, making it harder for poorer students to pay for higher education.

In response to the credit crisis and its effect on student loans, Congress passed emergency legislation increasing the amount of money students could borrow. Congress is also allowing the Department of Education to buy up government-subsidized loans from student lenders and will become a lender of last resort, in an effort to provide short-term liquidity to lenders

The problem is that College tuition is rising so fast, that many students can't pay their tuition bill with just grants and government-backed student loans. This is causing more students to turn to private student loans. But, with many lenders getting out of the student loan game, some students may find student loans will be more difficult to obtain than in the past.

Many colleges are switching away from private sector loans (FFELP), to the Direct Lending program. The Ensuring Continued Access To Student Loans Act increases the unsubsidized Stafford loan limits for undergraduate students by $2,000 per year and also allows the Parent PLUS loan to be deferred while the student is in school (and for a six month grace period after the student is no longer enrolled). This increase is good because it provides a better form of financial aid to students. When students exhaust all their scholarships, grants and federal loans, many look to private student loans, which in most cases, carries a higher interest rate and less favorable terms for the borrower. Federal loans are less expensive, more available and have better repayment terms than private student loans. This will also help borrowers with bad credit in obtaining sufficient financial aid, despite their ineligibility for private student loans.

College Cost Reduction and Access Act

President Bush signed the College Cost Reduction and Access Act of 2007, which will make college more affordable for low-income students by increasing the amount of Federal Pell Grants by more than $11 billion over the next five years. This means the maximum individual award a student can receive from the Pell Grant increases from $4,310 in 2007 all the way up to $5,400 by 2012.

Here are the highlights of the College Cost Reduction and Access Act:

- Pell Grant increases:

Increases $490 for the 2008-09 and 2009-10 award years.
Increases $690 for the 2010-11 and 2011-12 award years.
Increases $1,090 for the 2012-13 award year.

- Stafford Loan Interest rate cuts:

The bill also cuts interest rates on subsidized Stafford loans for undergraduate students in half over the next five years:
6.8 percent for loans disbursed July 1, 2006 to July 1, 2008
6.0 percent for loans disbursed July 1, 2008 to July 1, 2009
5.6 percent for loans disbursed July 1, 2009 to July 1, 2010
4.5 percent for loans disbursed July 1, 2010 to July 1, 2011
3.4 percent for loans disbursed July 1, 2011 to July 1, 2012

- Increase in Amount borrowed:

Undergraduates can borrow an additional $2,000 each year in unsubsidized Stafford loans at a fixed interest rate of 6.8%.

- Student Loan Forgiveness:

The College Cost Reduction and Access Act of 2007 establishes a new loan forgiveness program for those in public service. This new program will forgive all remaining student loan debt after 10 years of full time employment in public service. (Public service professions include those in government, military, public safety and law enforcement, public health, public education, public child care, social work, public legal services, public librarians, and employees of charitable organizations).

- TEACH Grants:

Students who are interested in teaching and have good grades can borrow another $4,000 each year for up to four years through the new TEACH Grant program.

When Looking for Student Loans

Just remember to be wary of your colleges "preferred lender" list. Though some may be honest, there have been numerous occasions of financial aid administrators receiving kickbacks from student loan companies. This was one of the main issues of the student loan scandal that has been uncovered over the last couple years.

When shopping for student loans, use this tool to compare student loan offers from multiple lenders. Here you can pick and choose between lenders, and shop around for various terms and interest rates.