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Education and Labor Committee

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Mr. Chairman, Mr. McKeon, Members of the Committee:

Thank you for this opportunity this morning to discuss the Administration's plan for higher education. As you know, President Obama has established a bold goal for America: to restore our place in the world as the country with the largest proportion of adults with college degrees. Having a more educated population is a worthy goal in and of itself. But this goal is about more than individual opportunity and social mobility. It is about the future of our economy and our place in the world. We must continue increasing the number of Americans pursuing higher education and redouble our efforts to ensure that more of them earn a credential.

This renewed American commitment to education spans from cradle to career. The Administration's 2010 budget request lays the foundation for the expansion of early childhood education. It promotes world-class standards and supports and rewards effective teaching. It expands efforts to turn around low-performing schools, including dropout-factory high schools. And for those

students who make the grade, we must ensure that they are able to go on to higher education and training. That is what I am here to talk about today.

The American Recovery and Reinvestment Act included a down payment on our higher education agenda. It expanded tax credits for higher education, making them larger and available to more families and to cover more types of expenses. It provided support to states to limit funding cuts and tuition increases at public universities. And it provided funding to pay for increasing Pell Grant costs and support a $500 increase in the maximum grant for students from lower-income families – combined with regular appropriations, the maximum grant will increase from $4,731 to $5,350 for the upcoming award year. We have taken further steps to help ensure that Americans who have lost their jobs know that their financial aid eligibility can be adjusted to reflect the fact that their prior income is no longer available.

Our FY 2010 budget proposal for financial aid aims to (1) secure the future of the Pell Grant program beyond the Recovery Act, (2) ensure reliable access to federal student loans, and (3) partner with states to sustain college access efforts and to intensify the focus on college completion. It is only by improving college retention and completion – for both traditional-age students and returning adults – that we can meet President Obama's challenge.

Pell Grants serve the families who are most struggling in our economy and in our schools. We tend to think of the program as one that serves students who are high school seniors. But how we design the program also sends messages to students, parents, and teachers much, much earlier. We need

to be able to tell students in middle school that the Pell Grant program is strong, and will be there for them in four to six years when they're ready to go.

That is why the President's budget calls for making the Federal Pell Grant program an entitlement. It is imperative that our students—from high school seniors to middle-school students—as well as their families, understand that indeed there will be money available for college when they're ready to apply. Research indicates that this is especially important if those students and their families are low income. Today's discretionary funding of Pell Grants leads to future uncertainty regarding the availability of student financial aid, and the near-term funding shortfalls of mandatory increases in the Pell Grant maximum award provided in the College Cost Reduction and Access Act (CCRAA) only increases that uncertainty. We firmly believe that concrete assurances today about the future availability of financial aid play a critical role in encouraging families to be certain their children undertake the academic preparation necessary for college.

Putting the Pell Grant program on a strong and predictable financial footing does take considerable resources. Fortunately, our plans for the student loan programs generate significant budget savings. This is accomplished by originating all new loans under the Direct Loan program beginning with the 2010-2011 academic year. Reliable access to student loans is important not just for our students and their families, but also for our entire economy. We have seen the guaranteed Federal student loan system, known as the Federal Family Education Loan (FFEL) Program, come close to collapse this past year. Repeated interventions by the Congress and the Department were required to ensure that every student and parent who needed a Federal

student loan received one. While I am pleased to report that these efforts were successful, I am less than pleased to report that the Department will have to replicate this year's efforts—and then some—to ensure continued FFEL availability for all for the 2009-10 academic year. This repair is only temporary, and Congress will need to decide the future of the Federal student loan system.

There are three functions to the student loan system, whether the loan is direct or guaranteed. First is raising the capital--the money that is actually lent to the student or parent borrower. Second is loan origination—providing the money to the borrower in exchange for a promissory note, the borrower's promise to repay the debt. Third is "servicing", which is the bulk of the actual work in carrying out a loan program. Servicing means sending out bills and payment notices, and receiving and applying payments to accounts. Servicing is following up when a borrower does not pay on time. Servicing is collecting on loans that have defaulted. Servicing means answering the telephone calls such as, "Do I have a payment due?" "Am I eligible for a deferment?" "Where do I send my address change?" Servicing is letting people know about the full range of options for repaying their loans. And much more.

In regards to raising capital, absent the extraordinary intervention by the Federal Government with direct Federal funds, FFEL loans would not have been universally available during the current academic year. By extending the loan purchase authority added to the Higher Education Act of 1965 (HEA) by the Ensuring Continued Access to Student Loans Act (ECASLA), Congress has made sure that lenders will have access to capital sufficient to ensure that FFEL loans will be universally available in the 2009-2010 award year.

Additionally, the Department has established an asset-backed commercial paper "conduit" to leverage the value investors place on federally-backed student loans to help further ensure the availability of FFEL loans next year. The Department's loan purchase authority, loan participation interest purchase and conduit programs, along with Direct Loans, have resulted this year, and will result next year, in the government's providing a large proportion of the capital to lend to federal student loan program borrowers. The 2010 Budget estimates that the Federal government will finance nearly three quarters of all student loans in both 2009-2010 and 2010-2011 academic years. And, as I said earlier, these loan purchase authority programs will come to an end. Congress must make a decision about the future of the student loan programs. Instead of maintaining this elaborate web of programs designed to prop up the FFEL program, we should originate 100% of new loans through the less costly Direct Loan program.

With respect to expanding the origination of Direct Loans, we already have a uniform, on-site system at every college, university and postsecondary trade and technical school in the country for originating, disbursing, and reporting Pell Grants. The Common Origination and Disbursement (COD) system is a contractor-operated platform through which schools receive their funding authority from the Department, draw down funds from the Department for payments to students, and then provide data back to the Department for those students who received Pell Grants.

Expanding the capability of COD to originate and disburse student loans and then report that information back to the Department is an easy add-on for those schools that do not already disburse Direct Loans. In fact, not only do

Direct Loan program participating institutions use COD for this purpose today, but the Department used COD's common student record approach to implement successfully the authorizing, disbursing and reporting requirements for the Academic Competitiveness, National SMART, and Teach Grant programs within extraordinarily condensed timeframes. The single significant difference between administering a Pell Grant and administering a student loan, whether guaranteed or direct, is the promissory note that must be signed by the borrower. In the FFEL program today, schools must follow certain lender-specific processes, and they must have a signed promissory note in hand prior to disbursing loan funds. Current Pell Grant participating institutions that move from FFEL into Direct Loans may have to learn a somewhat different process, but it is not something that is enormously complicated.

Also with respect to student loan origination, it is important to note that FFEL program lenders by and large do not make the usual underwriting decisions that lenders otherwise make. Outside the student loan arena, lenders decide what interest rates to charge, how much to lend, and to whom to lend to. Indeed, we see this typical lender behavior in the private-label student loan market, in which FICO scores and type of institution attended are important underwriting considerations. In other words, lenders assess risk in making their lending decisions—except for federal student loans. Basically these underwriting decisions are replaced by criteria established by Congress for federal student loan borrowers, including annual and cumulative loan limits, the cost of attendance, and the availability and receipt of other student financial assistance by the borrower, and with the administration and

coordination of all these activities accomplished by college and university financial aid administrators.

Let me talk for a moment about loan servicing. In our view, servicing Federal student loans, irrespective of loan program, should address the two main goals that we want to achieve: default prevention and customer service.

Regarding default prevention, the Department's cohort default rate data show wide variation in these rates over the years when arranged by lender. Certainly there may be good reasons for different lenders having different default rates—portfolio composition and expanding and contracting local economies, to name just two—but we do little, if anything, in the FFEL program to encourage FFEL institutions, and prospective and continuing FFEL borrowers to turn to those lenders (or their servicers) that seem to rise to the top of the list in terms of success in preventing defaults.

In fact, before its 2007 repeal, the statutory provision that granted "exceptional performer" status—and thus increased insurance payments—to lenders, servicers, and guaranty agencies was based on an acceptably high compliance rate—97 percent—with the Department's due diligence requirements for loan servicing and collection rather than a straightforward, objective, and transparent measure of success in preventing defaults. In other words, we rewarded FFEL program participants for compliance with process rules instead of for achieving desired results.

Guaranty agencies also have, at least nominally, a role in default prevention. However, the existing guaranty agency financing model creates incentives

that arguably favor collecting on defaults instead of preventing defaults. In short, if more value is attached to collecting defaults than preventing defaults, then there are likely inadequate incentives to prevent defaults in the first place.

Nevertheless, we believe many guaranty agencies provide significant and worthwhile services to students and families. The President's Budget calls for the creation of a State-Federal partnership fund aimed at improving college success and completion, particularly for students from disadvantaged backgrounds. States could use a portion of these funds to continue the college outreach and information activities now supported by federal subsidies to guaranty agencies and other state-affiliated FFEL participants. If we think these services are valuable, then we as a Federal government should pay for these services directly instead of hoping that Guaranty Agencies will use a portion of their fees for these worthwhile activities.

Regarding customer satisfaction, good customer satisfaction means that student and parent borrowers receive the information they need when they need it and in the form that they find most useful. So it is important to have the appropriate mechanisms in place to gauge customer satisfaction. The Department has employed such surveys in the past and we know that our Direct Loan servicer has performed as well, and sometimes better, under its contract than its FFEL industry counterparts. We also know that there are FFEL servicers with above-average rated customer satisfaction performance. So, given our increasing portfolio, due both to the recent expansion of the Direct Loan program and our acquiring significant numbers of FFEL loans via

the loan purchase authority, the Department will contract with multiple private-sector student loan servicers.

We intend for our servicing contracts to leverage competition among private firms, so that those servicers that do a better job in terms of default prevention and customer satisfaction will receive an increased share of the Federal student loan portfolio to service. Conversely, those firms that are less adept will have a smaller share of that portfolio to service over time.

We are sensitive to the concerns expressed by the FFEL program community and others regarding jobs. However, annual Federal student loan volume is not declining. We will need at least as many people in the private sector servicing student loans in the future—whether they are traditional FFEL loans, FFEL loans purchased by the Department, or Direct Loans—as we have today. It will be the Department's job to build into our contracts the proper set of incentives so that we get the best service for our borrowers and the taxpayers.

We are sensitive as well to the needs of those students and families whose circumstances are such that the annual loan limits in the FFEL and Direct Loan programs are inadequate. But, in recent years, too many students have turned to private-label loans without ever considering these Federal loan programs.

To address these issues we are proposing to reinvigorate and refocus the Federal Perkins Loan program. Merely increasing loan limits for all borrowers could lead to over-borrowing. Instead, under our budget proposal, the annual

Perkins Loan volume would increase from approximately $1 billion per year to $6 billion. This would be in the form of lending authority for both undergraduate and graduates, allocated to institutions by a formula that may include factors to encourage colleges to control their costs and offer need-based aid to limit indebtedness, and reward colleges for enrolling and graduating students from low-and middle-income families. Our expanded and modernized Perkins Loan program would retain the current five percent interest rate and contain a "hold harmless" for schools currently in the program, while eliminating the burden on schools to service and collect on the new Perkins loans.

In closing, our student aid proposals would address important servicing issues by providing for construction of loan servicing contracts with multiple private-sector firms with appropriate incentives to ensure high-quality customer service while minimizing defaults. Our proposals would minimize program transition issues for institutions through the use the existing common student record approach of the COD system to provide for student loan origination functions for all institutions. As for capital acquisition for federal student loans, it is clear that the Federal Government is now the sole reliable and sufficient source of Federal student loan capital. The Administration's proposed model would provide for a highly efficient student loan system by minimizing the layers between the source of loan capital and the borrower—the ultimate beneficiary of that loan capital. Alternative models add additional layers, which must be evaluated in terms of whether the often uncertain benefits of the additional layers outweigh their certain costs. We must preserve the maximum possible investment in the Pell Grant program and the future of America's college students.

Thank you Mr. Chairman and I will answer any questions you and the other Committee Members might have.