Leveraging Private Sector Participation in the Federal Student Loan Program to Protect Taxpayers and Assist Students and Families

Since passage of the Health Care and Education Reconciliation Act in 2010, the U.S. Department of Education is responsible for originating all new federal student loans at a pace of nearly $100 billion per year. The Direct Loan portfolio now stands at $949 billion and is expected to continue to grow at a substantial rate, leaving taxpayers at significant risk as default rates, severe delinquencies, and the cost of generous loan forgiveness programs continue to rise. The private sector – led by state and nonprofit higher education agencies – can do a better job of administering and managing the nation's student loan programs than the federal government.

One of the biggest obstacles to leveraging a greater role for the private sector is that the costs and benefits of federal student loan programs are measured under the terms of the Federal Credit Reform Act of 1990 (FCRA),which incorrectly shows the federal government makes money off of student loans. Under FCRA, the costs of federal student loan programs are recorded up front on an accrual basis, and only account for the gain and loss of future cash flows. These costs ignore the impact of market or financial risk arising from changes in employment and the economy; in this case, the federal government is exposed to such risk when the economy is weak and borrowers default on their debt obligations more frequently and collections are lower. The FCRA also ignores the significant administrative costs to run the massive student loan program, including servicing and collection costs, and, based on recent experience, underestimates the subsidy cost of forgiveness programs that have been promised to student borrowers.

Many higher education experts from both sides of the political spectrum, including the New America Foundation, American Enterprise Institute, and Heritage Foundation, believe that the federal government's arcane accounting rules dramatically overstate the benefits and understate the costs of the Federal Direct Loan program to the nation's taxpayers. The nonpartisan Congressional Budget Office (CBO) recommends the costs of student loans be assessed using "Fair-Value Accounting," which factors in market risk and is a more comprehensive estimate of federal costs. CBO estimates that the Department's four largest student loan programs would yield a budgetary savings of $135 billion under FCRA accounting over the next 10 years, <u>but would cost $88 billion when using the more accurate Fair-Value Accounting</u>. In short, the federal government will be forced to borrow $223 billion to cover the costs of the federal student loan program, when factoring in the shortfall and the questionable budget assumptions.

The impact of the current flawed accounting policy includes the following:

- Congress and the Administration have used the questionable budgetary assumptions (that the federal government makes money off of student loans) to dramatically increase loan limits for its student loan programs, driving more student and parent borrowers deeper into debt.

- Federal policymakers have used FCRA scoring to overstate the benefits of Direct Loans, ending the private sector's involvement in the federal student loan programs. The loss of competition has ended borrower benefits offered by many state and nonprofit organizations, ended localized and personalized services to students and families, and put thousands of private sector employees out of work.

- FCRA accounting has underestimated the long-term budgetary and real-world costs of the federal government as the primary holder and servicer of federal student loans. These costs, which will total $88 billion over the next 10 years, will be shouldered by the nation's taxpayers as the amount of total loan volume continues to rise.

In 2015, Congress passed Senate Concurrent Resolution 11, which requires CBO to ensure that student loan-related legislation includes an additional cost estimate measured on a fair-value basis. However, this important provision is limited to determining compliance with the Congressional Budget Act of 1974 and does not change the Office of Management and Budget or the Department's use of FCRA's flawed methodology.

With the explosion of student debt (which totals nearly $1.3 trillion, outpacing credit card and auto debt), rising default rates (now totaling over 11 percent of all borrowers), and the growing size of the federal government, federal policymakers must take action to reform the nation's student loan programs.

NCHER Reform Proposals

The National Council of Higher Education Resources (NCHER) believes the private sector can play an important role in higher education. We urge Congress to leverage private sector participation in the federal student loan program to protect taxpayers and assist students and families by:

- Requiring federal agencies to use Fair-Value Accounting when measuring the true costs of federal credit programs. Current budget scoring rules mask the true cost of the Federal Direct Loan Program, understating the short- and long-term costs to the nation's taxpayers. Budget experts, including CBO, argue that Fair-Value Accounting and measuring market risks provide a more comprehensive and accurate picture of the costs of Federal Direct Lending. Under current budget accounting, Direct Lending is projected to provide the federal government with a $135 billion "profit" over the next 10 years, while under Fair-Value Accounting the government is projected to incur an $88 billion loss over the same period. Congress should pass the "Budget and Accounting Transparency Act," introduced by Sen. Deb Fischer (R-NE) in the 114th Congress, which would require federal agencies to use Fair-Value Accounting when measuring the true costs of federal credit programs. This important legislation would remove the incentive for the federal government to lend more, piling higher levels of debt on students and parents who increasingly are encountering repayment difficulties.

- Enhancing the role of private capital and local expertise in financing the cost of college and administering student loans. Once the federal government is able to utilize a more accurate measurement of its credit programs, Congress should examine a number of proposals to enhance the role of private capital and local expertise in financing the cost of college and administering education loans. Such ideas could include removing the federal debt off of the nation's balance sheet and decreasing taxpayer exposure, a concern from officials at the U.S. Treasury Department, or examining the merits of creating a public-private partnership, led by state and nonprofit lenders, loan holders, servicers, and collectors, for funding and administering federal student loans that would prove to be a more beneficial approach for students, families, and taxpayers.

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