THE FEDERAL STUDENT LOAN PROGRAM

Introduction

The federal student loan system was created in 1965 when Congress passed the Higher Education Act encouraging states to initiate and administer student loan programs. Since then, the program has been revised many times and has grown into a huge enterprise that would be unrecognizable to those who established it in the 1960s. South Dakota students, like their counterparts around the nation, have relied on the federal student loan system as the costs of higher education continue to increase.

Federal Student Loan Programs

The federal student loan program is part of a group of federal Student Federal Assistance programs that includes loans, grants, and work-study programs. Financial aid in the form of grants and scholarships awards does not have to be repaid by the student, while loans must be repaid after graduation. The most well-know federal grant program is the Pell grant program, which provides grants to students on the basis of student need. More than 5,000 academic institutions participate in the Pell grant program. For the 2007-2008 school year, the maximum annual Pell grant award is $4,310 per student.

The federal student loan program began in 1965 when Congress established the Guaranteed Student Loan Program as part of the 1965 Higher Education Act. The program was small and intended for students in financial need. Because these loans were inherently risky, the federal government provided incentives to states and financial institutions to participate. States were given funds to establish “guarantee agencies” to insure lenders against losses from defaulted loans, and lenders were given a guaranteed interest rate to reduce their risk, as risk was shifted to the federal government. In 1972, Congress expanded the amount of funds available to lenders by creating the Student Loan Marketing Association (SLMA or “Sallie Mae”). Sallie Mae provided a secondary market for student loans by buying student loans from banks to free up lender money for additional student loans. However, defaults and inferior services or lack of services in some areas led Congress to amend the Higher Education Act in 1976 to further encourage the establishment of state student loan guarantee agencies, to authorize the creation of state-run secondary markets in addition to Sallie Mae, and to increase federal protection for state loan guarantee agencies. These policies increased money available for student loans and again reduced risks to lenders and to states.

Over time, the nature of the federal student loan program changed as more money for student loans became available, as the risks to states and lenders decreased, and as eligibility requirements for federal student loans were loosened. Federal student loans eventually became available to all students, regardless of income levels. Student borrowing increased from $1.8 billion in 1977 to $12 billion in 1989 to $52.1 billion in 2004. The creation of state guarantee agencies and other secondary markets and the huge increase in loan volume led to an increasingly complex and cumbersome system that was not necessarily structured for administrative efficiency. Through the 1980s, default levels increased, while increasing tuition costs continued to drive increases in loan volumes, all of which increased the size and complexity of the federal student loan machinery.

In 1992, Congress established a federal direct student loan pilot program to provide loans directly from the federal government to students, with the intention of creating a more efficient lending system by eliminating the need for private banks, state guarantee agencies, and secondary markets. In 1993 the direct loan program was expanded into an ongoing student loan program. The direct loan program was originally intended to replace the original loan program, but Congressional action in 1998 allowed both programs to continue. Since then, the federal government has operated the two programs in competition with each other as the federal student loan system continues to evolve. The original Guaranteed Student Loan Program, which was renamed the Federal Family Education Loan Program (FFELP) in 1992, and the new Federal Direct Lending Program (FDLP), created in 1992 and expanded in 1993, continue to provide for the issuance of federal student loans. Both handle the same types of federal loans to individual students, and postsecondary education institutions apply to participate in one or both programs. Students obtain loans from either program as determined by their school.

South Dakota Student Loan Structure

In South Dakota, legislation was enacted in 1966 to provide for a higher education loan guarantee program to act in conjunction with the recently passed federal legislation. The program is codified in SDCL Chapter 13-56, and the Board of Regents was designated as the original oversight agency. Later, these oversight functions were transferred to the Department of Education. In 1978, the South Dakota Education Assistance Corporation (EAC) was designated as the guarantor agency that would administer the guaranteed student loan program in South Dakota. In 1979, the EAC established the Student Loan Assistance Corporation, later known as the

Student Loan Finance Corporation (SLFC), as a private, nonprofit entity to provide lenders with a secondary market for the student loan program in South Dakota. SLFC did this by selling bonds to the public and using the proceeds to purchase student loans from lenders, enabling the lenders in turn to make more loans to students. When SLFC was formed, only a few banks in South Dakota participated in the student loan program. After it was formed, every lender in the state, except one, participated. EAC and SLFC existed as separate entities because federal law prohibits a corporation from being both the holder of the loans and also acting as the guarantee agency.

The EAC and SLFC, both located in Aberdeen, perform different functions but share a common purpose of making education loans available for South Dakota students. Both began as private, nonprofit corporations, although the SLFC in 1998 was reorganized and renamed as the Great Plains Education Foundation. The primary purpose of the foundation is to provide grants to educational institutions to improve higher education in South Dakota. The Great Plains Education Foundation then formed a new SLFC as a for-profit, wholly-owned subsidiary to continue servicing the federal student loan program. EAC and the new SLFC are distinctly different corporations involved in different aspects of the federal student loan program, with different buildings, management, and employees. EAC remains as South Dakota's guarantor agency in administering the federal student loan program.

Types of Federal Student Loans

The Federal Family Education Loan Program (FFELP) and the Federal Direct Student Loan Program (FDLP) provide three primary types of student loans: Stafford Loans, which are offered as subsidized (need-based) and unsubsidized (open to all students regardless of income); Parent Loan for Undergraduate Students (PLUS), which allow parents to borrow additional money to supplement their child's financial aid; and GradPLUS loans, a new loan for graduate students who have reached Stafford loan limits. Of these, Stafford loans are the most common. Repayment of federal student loans typically begins six months after the student graduates or leaves school. FFELP and FDLP also authorize consolidation loans, which consolidate existing student loans after graduation and are governed by federal requirements and interest rate limits. Another common federal student loan that is not part of FFELP or FDLP is the federal Perkins loan program, a need-based loan program operated directly by education institutions.

Stafford Loans. Stafford loans may be issued either under FFELP of FDLP programs with essentially the same rates and terms. Stafford loans may be issued as "subsidized" or "unsubsidized." An unsubsidized Stafford loan is not need-based and does not have income limits or other financial criteria in order for a student to be eligible. Most students are eligible for Stafford unsubsidized loans. Repayment of the principal of an unsubsidized Stafford loan is deferred until six months after the student graduates or leaves school, but interest accrues while the student is in school and can be repaid then or can be added to the principal and paid when the student begins paying on the loan.

To qualify for a subsidized Stafford loan, a student must have financial need. The benefit of a subsidized Stafford loan is that the student is not charged interest until the repayment period begins (six months after the student graduates or leaves school).

Stafford Loan Limits and Requirements. The yearly amount that a student may receive through a Stafford loan is the same for subsidized and unsubsidized loans and increases while the student is in school. Yearly Stafford loan limits are as follows (effective July 1, 2007):

Dependent students:	
Freshman	\$3500 annual loan limit (Stafford Loans)
Sophomore	\$4500
Junior, Senior, Fifth Year+	\$5500
Independent Students:	
Freshman	\$7500
Sophomore	\$8500
Junior, Senior, Fifth Year+	\$10,500
Graduate or Professional Students:	\$20,500

The lifetime amounts that students may borrow through Stafford loans are as follows:

Undergraduate dependent lifetime limit	\$23,000
Undergraduate independent lifetime limit	\$46,000
Graduate or professional lifetime limit	\$138,500

Note that there are a number of exceptions to the Stafford loan limits presented above, but the information shown here applies to the vast majority of students obtaining Stafford loans. Also, the limits presented above include increases that took effect for the 2007-2008 academic year based on changes in federal law.

The interest rate for Stafford loans disbursed after July 1, 2006 is fixed at 6.8%. Previously, Stafford loan interest rates were variable, based on the 91-day T-bill rate plus 1.7% while the student was in school, with an additional 0.6% increase at graduation, and capped at a maximum of 8.25%. The change in rate that became effective in 2006 does not affect interest rates on loans made before July 1, 2006. All lenders must offer the same rate on Stafford loans, although some give discounts for on-time payment and for electronic payments.

There are several repayment options for Stafford loan recipients. Principal and interest payments are made each month for a maximum term of ten years. Under the graduated repayment program and the income-sensitive repayment program, payment amounts vary depending on the borrower's income level or on whether the borrower is at an early or late stage of the repayment term. For certain students with high student loan debt, the term can be extended to twenty-five years. Many students consolidate all their student loans after graduation, which revises the repayment term and payment options in most cases. Student loan consolidation will be discussed later in this paper.

PLUS Loans. Parent Loans for Undergraduate Students (PLUS) allow parents to borrow additional funds for their child's college expenses. PLUS loans can be made through FFELP or FDLP. The annual limit for PLUS loans is the cost of attendance minus any other financial aid the student receives. For PLUS loans disbursed after July 1, 2006, the interest rate is fixed (7.9% for PLUS loans under FDLP and 8.5% for PLUS loans issued under FFELP). PLUS loans issued before July 1, 2006 have variable rates. There are no income or collateral requirements for obtaining PLUS loans, although applicants are subject to credit checks and cannot be in default on other student loans. Repayment on PLUS loans begins sixty days after the loan is disbursed, and interest begins to accrue at the time the loan is disbursed. Loan payments are not deferred while the student is in school, and there is no post graduation grace period for PLUS loans. Repayment of PLUS loans is over a ten-year period and payment options are similar to Stafford loans, with standard, graduated, and income-sensitive repayment options.

GradPLUS Loans. The GradPLUS loan program is a new loan option for graduate and professional degree students. GradPLUS loans are made to students, not parents, and allow the recipient to borrow their cost of attendance for the academic year minus other fianancial aid received. In addition, the student must have applied for his or her maximum annual Stafford loan eligibility before applying for a GradPLUS loan. The interest rate for GradPLUS loans is a fixed 8.5% under FFELP and 7.9% under FDLP. Repayment requirements and options for GradPLUS are similar to those for PLUS loans.

Perkins Loans. Perkins loans are need-based and are not operated under FFELP or FDLP, although they are federal student loans. Perkins loans are disbursed and administered by the educational institution that the student attends. Each school that participates in the federal Perkins loan program receives a certain amount of funds each year from the U.S. Department of Education. When the school's

Perkins funds for that year are distributed, no more Perkins loans can be made by the school for that year. Perkins loans may be made to both undergraduate and graduate students, based on financial need.

For undergraduate students, the maximum Perkins loan is $4,000 per year up to a maximum of $20,000 total as an undergraduate. A graduate student may receive up to $6,000 per year as a graduate student and a maximum overall total of $40,000 in Perkins loan funds, including the student's undergraduate Perkins loans. The interest rate for Perkins loans is 5%, and students have up to ten years to repay, depending on loan amount. The repayment period for Perkins loans does not begin until nine months after the student graduates or leaves school. Under the Perkins loan program, the lender is the school, and the student repays the school or the school's agent. Perkins loans are offered to students having the greatest financial need in the loan category (federal Pell grants go to students with the greatest overall need).

Consolidation Loans. Federal law provides for the consolidation of federal student loans and includes restrictions and requirements related to interest rates and repayment terms. Federal student loans may be consolidated under the federal student loan consolidation program using the direct loan process under FDLP or by private lenders through FFELP. Loans that may be consolidated include Stafford, PLUS, GradPLUS, and Perkins loans, as well as other specialized federal student loans. (Parent and student loans cannot be consolidated together, but parents and students may consolidate their loans separately.)

Consolidation loans pay off the student's existing student loans and combine them into one loan from one lender with one monthly payment, usually over a longer period of time. The consolidation process reduces monthly payments, but increases the amount of interest paid. The interest rate for federal consolidation loans is the weighted average of the interest rates on the loans being consolidated, with an upper limit of 8.25%. Federal student loans can be consolidated during the grace period (six months after graduation or leaving school) or later. Students are no longer allowed to consolidate while they are still in school, although parents can consolidate PLUS loans at any time.

Consolidation loans offer several repayment plans in addition to the standard ten-year repayment period. These include extended repayment, graduated repayment, and income contingent (FDLP) or income sensitive (FFELP) repayment. The repayment term can be extended up to 30 years, depending on the amount of the loan. Repayment of a consolidation loan begins 60 days after the funds are disbursed. Consolidation loans allow prepayment of principal without penalty.

Applying for Federal Student Loans - FAFSA. The first step in applying for virtually all forms of federal student aid, including grants, loans, and work study aid, is for the student to complete a federal form known as the Free Application for Federal Student Aid or FAFSA. The FAFSA is filed before the student applies for initial federal student aid and is renewed each academic year thereafter. The FAFSA can be done manually on paper and sent by mail, or it can be done electronically. The FAFSA is a standardized form used for all federal aid and also used by many schools and states in administering their aid programs.

The FAFSA form requests a large amount of financial and tax information for both the student and the student's parents, which is used to generate a dollar amount known as the Expected Family Contribution (EFC). The Expected Family Contribution is used to determine the amount of aid for which the student qualifies and whether the aid will be in the form of grants or loans, subsidized or unsubsidized. The Expected Family Contribution number does not affect a student's ability to receive a basic Stafford unsubsidized loan, however. An incoming freshman student can specify several schools that will receive his or her FAFSA information if the student has not yet decided on a school.

Typically, the student's financial aid award package will arrive during the summer and the student will respond as to whether he or she accepts or declines the award or wishes to receive or borrow a lesser amount. The annual award is divided into semesters and disbursed to the school at the beginning of each semester. The school deducts tuition, fees, and on-campus living expenses, if applicable, from the award, and forwards any remaining funds to the student (this usually occurs if the student lives off campus). The student receives periodic notices about the status of his or her student loans and is notified of options upon graduation or leaving school.

Private Loans - College Costs and Trends

One of the reasons for the creation of the federal student loan program in the 1960s was that private lenders were reluctant to risk making loans to college students. However, after 20-30 years' experience with managing federally supported student loans, many lenders began to see opportunity for new and profitable markets in making private loans to students. Record numbers of students were enrolling in college, and rising tuition rates led many students to seek additional loans once their federal loans were exhausted. Some students simply borrowed from private lenders, avoiding the paperwork that goes with federal student loans, even though private loans can be significantly more costly than their federal counterparts. Some students were simply not aware of the options available for lower-cost federal student loans. Private lenders marketed their loans directly to students and parents, bypassing college and university financial aid offices.

Private lending to college students increased from nearly $4 billion in 2000 to $16 billion in 2006. Borrowing through private student loan programs accounted for 20% of all education borrowing in 2005-2006. These developments marked a significant change in the relationship between schools, lenders, and borrowers. Loan companies also began to develop private consolidation loans for student borrowers during the 1990s, again without the involvement of college financial aid offices. Reliable data on the amount of student borrowing from private sources is scarce, and total student debt load is uncertain when private student loans are added to federal student loans. It is clear, however, that the private student loan market has increased significantly over the last 10 to 15 years.

Student Loan Data

Student loan debt has been increasing in recent years as college tuition costs increase and as a larger percentage of high school graduates enroll in college. The following information is from The Project on Student Debt, an initiative of the Institute for College Access and Success, Berkeley, California. The data comes from surveys of public and private higher education institutions around the nation and includes both federal student loan debt and private student loan debt. Parent PLUS loans are not included. The debt totals represent cumulative student loan debt for undergraduate students who graduated or left school in 2006.

Debt per Student - Class of 2006. The following table presents student loan data for the ten states with the highest per student debt in 2006, the ten states with the lowest student debt in 2006, data for South Dakota students, data for surrounding states, and national averages. South Dakota students ranked eleventh in the nation in the amount of student debt in 2006. (Note that not all states reported, making the total ranking less than 50.)

States	Average Debt per Student at Graduation in 2006 and Rank	
(Highest debt states)		
District of Columbia	$27,757	1
New Hampshire	24,800	2
Vermont	23,839	3
Connecticut	23,469	4
Minnesota	23,375	5
Iowa	22,926	6
Maine	22,877	7
Pennsylvania	22,776	8
Indiana	21,179	9
Michigan	21,169	10

South Dakota	**$21,103**	**11**
North Dakota	20,644	14
Nebraska	19,198	25
(Lowest debt states)		
Oklahoma	17,680	37
Illinois	17,650	38
Kansas	17,617	39
Delaware	17,589	40
California	17,270	41
Maryland	16,872	42
Wyoming	16,855	43
Kentucky	15,406	44
Utah	12,807	45
Hawaii	11,758	46
National Average	$19,646	--

(Source: The Project on Student Debt)

Percentage of Students with Debt - Class of 2006. In comparing the percentage of students who graduated or left school holding some amount of student debt, South Dakota students ranked highest in the nation. In 2005, 82% of South Dakota students held student debt, and in 2006, 84% of South Dakota students held student debt.

State	Percentage of Students with Debt at Graduation in 2006 and Rank	
(High percentage debt states)		
South Dakota	**84%**	**1**
Iowa	74%	2
Maine	72%	3
Minnesota	72%	4
New Hampshire	71%	5
Pennsylvania	69%	6
Idaho	68%	7
Oregon	67%	8
New York	66%	9
Vermont	66%	10
North Dakota	66%	11
Nebraska	64%	15
(Lowest debt percentage states)		
Florida	51%	37
District of Columbia	49%	38
Delaware	48%	39

Arizona	48%	40
Colorado	48%	41
California	47%	42
Wyoming	44%	43
Tennessee	42%	44
Utah	31%	45
Hawaii	29%	46
National Average	58%	--

(Source: The Project on Student Debt)

Additional South Dakota Student Debt Statistics. Clearly, South Dakota students face significant debt loads in comparison with students in most other states, although student debt is a major factor in financing higher education all over the nation. The data below was compiled by the South Dakota Board of Regents through their Financial Aid Survey. Debt amounts from the Regents survey differ slightly but not significantly from the data shown in The Project on Student Debt tables above. Board of Regents data show that the average student loan debt for fall 2005/spring 2006 graduates of Board of Regents Institutions was $20,949. At Regents institutions, 62% of overall student aid is from federal student loans, ranging from 54% at South Dakota School of Mines and Technology to 70% at the University of South Dakota. Systemwide, 4.8% of student debt is from private or alternative loans, and 95.2% is from federal student loans.

School	Average Student Loan Debt for Fall 2005/Spring2006 Graduates (Baccalaureate Degrees)
Black Hills State University	$19,266
Dakota State University	20,638
Northern State University	21,123
S.D. School of Mines and Tech.	22,150
South Dakota State University	20,402
University of South Dakota	22,116
System Average	$20,949

(Source: South Dakota Board of Regents)

State Alternative Loan Programs. A few states, including Minnesota, New Jersey, and Texas operate alternative state student loan programs, which provide another source of student loans, in addition to loans from the federal student loan program and private student loans.

Minnesota's Student Educational Loan Fund (SELF) Program provides student loans for students and families who have exhausted or do not qualify for need-based aid. SELF loans are open to both Minnesota residents and nonresidents who attend qualifying educational institutions. The SELF program began in the 1994-95 school year with 8,791 loans for $24.2 million and an average loan of $2,753. In Fiscal Year 2007, 30,577 students borrowed approximately $135.3 million in SELF loans for an average loan amount of $4,425. The SELF program does not receive state appropriations. The SELF program is funded through the issuance of revenue bonds which are repaid from interest earnings. Before applying for a SELF loan, a student is required to seek other sources of federal and other aid for which they may be eligible. Undergraduate students may borrow up to $7,500 per year under the SELF program, with a maximum cumulative amount of SELF loans of $37,500 for an undergraduate student. Graduate students may borrow up to $9,000 per year and may not exceed $55,000 in total SELF loan debt, including both undergraduate and graduate loans. Interest rates for SELF program loans are variable.

Recent Developments

During early 2007, allegations of scandal in the student loan industry arose as some student loan lending companies were accused of providing kick-backs to college financial aid officials, and some U.S. Department of Education officials were suggested to have had overly close ties with lenders. There were also allegations of excessive profits by student loan lenders in the $85 billion per year student loan industry, highlighted by the sale of Sallie Mae, the largest student lender, for $25 billion. Sallie Mae's five-year return on equity was 52%. Sallie Mae was converted from a government-sponsored enterprise to a completely private, for-profit company in the late 1990s and has become the largest player in the student loan industry.

In response to these developments, as well as other trends in the student loan industry, numerous pieces of legislation were introduced in Congress. Legislation was passed in September 2007 that will increase funding for Pell Grants and forgive loans for students entering certain public service professions, to be paid for by reducing federal subsidies to lenders by approximately $20 billion.

Summary

The federal student loan program has changed drastically since it was created in the 1960s by offering federal financial incentives to private lenders in order to get them to participate in the program. Since then, the student loan program has evolved into a multibillion dollar industry with a huge and complex array of governmental and quasigovernmental agencies and private entities competing for student borrowers. The cost of obtaining a college education has increased dramatically, along with the number of students entering college, leading to an almost inevitable increase in education-related debt for students and parents. The resulting long-term debt in some cases causes significant problems as young people enter the workforce and attempt to make their way in the world.

In South Dakota, there is some cause for concern. Even though higher education in South Dakota is relatively inexpensive, the percentage of South Dakota students carrying student debt ranks highest in the nation, and the amount of that debt ranks eleventh among the states. South Dakota students are apparently able to obtain loans to finance their higher education efforts, but are unable to assemble an adequate combination of personal funds and grant and scholarship awards to keep pace with their peers in other parts of the nation.

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This issue memorandum was written by Tom Magedanz, Principal Research Analyst for the Legislative Research Council in November, 2007. It is designed to supply background information on the subject and is not a policy statement by the Legislative Research Council.