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Action /Information Item

Governmental Relations Committee

Federal Issues Update

Enclosed is a summary of federal issues that affect the student loan and grant programs. Current issues addressed in the enclosure include an update on; 1) the Reauthorization of the Higher Education Act, 2) an update on the reconciliation bill and its potential effects on student loans.

Recommended Action:	For information and consideration of actions on bills and policies affecting the Commission's programs.
Responsible Staff:	Steve Caldwell, Acting Chief, Governmental Affairs and Research

FEDERAL ISSUES UPDATE

THE DEFICIT REDUCTION ACT

Prior to recessing for the holidays, the House and Senate agreed on a budget reconciliation bill. However, because the Senate made a few minor non-education changes, the bill needed to return to the House for final consideration. The higher education community looked forward to action on the conference report which was expected when the House returned on January 31st. The House did vote on the bill on Wednesday, February 3rd and approved S 1932, the *Deficit Reduction Act of 2005*, by a narrow margin of 216-214. The bill has been sent to the President for his signature. The Congressional Budget Office (CBO) now estimates that the deficit reduction package will result in $39.4 billion in savings over five years, including $11.9 billion in cuts to student loans. The major provisions of the bill are listed below.

REAUTHORIZATION OF THE HIGHER EDUCATION ACT

The pending reauthorization of the Higher Education Act was extended until March 31, 2006 with hopes that Congress could pass it by then but many in Washington expressed doubt. Once the House returned to session on February 1, there are only six to eight weeks to confer with the Senate and agree on a final bill. Staff will continue to provide updates on these issues as more information becomes available.

ELECTION OF THE MAJORITY LEADER

In an additional action, by a vote of 122-109, Republicans members of the House of Representatives elected Representative John Boehner (R-Ohio) Chairman of the House Education and the Workforce Committee, to succeed Representative Tom Delay (R-Texas) as the House Majority Leader. Boehner defeated Acting Majority Leader Roy Blunt (R-Missouri) after Representative John Shad (R-Arizona) dropped out of the race. A new Chairman of the House Education and Workforce Committee will be named later.

COMMISSION ON THE FUTURE OF HIGHER EDUCATION

The United States Secretary of Education established The *Secretary of Education's Commission on the Future of Higher Education* which will meet at venues around the country to discuss the national responsibility to make sure that the best system of higher education in the world continues to meet our nation's challenging needs for an educated and competitive workforce in the 21st century. The Commission will host a national dialogue with the following in mind:

- Over 80 percent of the fastest-growing jobs require at least some postsecondary education;
- In today's global economy, the best jobs go to the most skilled and most motivated workers;
- How can we ensure that college is affordable and accessible; and
- How well are institutions of higher education preparing our students in the new global economy?

The Commission met in San Diego on February 3rd and 4th to discuss these important topics and will present recommendations after completing its public hearings.

THE AMERICAN COMPETITIVENESS INITIATIVE

President Bush laid out his agenda for the coming year in the annual State of the Union speech on January 31st by outlining four major initiatives concerning American leadership and global competitiveness and the need for alternative energy sources and affordable healthcare.

Regarding education, the President introduced the American Competitiveness Initiative, designed to increase funding in “critical research,” and in the fields of math and science by:

- Doubling the federal commitment to research programs in physical sciences;
- Encouraging rigorous math and science courses;
- Providing early help to students struggling in math;
- Making permanent the research and development tax credit; and
- Expanding the Advanced Placement (AP)/International Baccalaureate (IB) programs among others.

Funding for the initiative would be provided by allocating $5.9 billion in FY 2007 and $136 billion over 10 years.

Major Provisions Affecting Student Loans in the
Higher Education Reconciliation Act of 2005
(Title VIII of the Deficit Reduction Act of 2005 (S. 1932))

As noted above, the Deficit Reduction Act of 2005, which cuts $39.4 Billion in spending, $11.9 billion of which comes from Higher Education, has been sent to the President for his approval. The following are highlights of the major provisions of the bill. For your information, we have also included a complete summary of the Major Provisions Affecting Student Loans prepared by the National Council on Higher Education Loan Programs (NCHELP).

Loan Program Reauthorized
- Sunset dates for Federal Family Education Loan Program (FFELP) extended through FY 2012.

Loan Limits
- First- year Stafford limit increases from $2,625 to $3,500.
- Second- year Stafford limit increases from $3,500 to $4,500.
- Unsubsidized Stafford limit for graduate and professional students increases from $10,000 to $12,000.
- Undergraduate and graduate aggregate limits are unchanged.
- Loan limit increases take effect July 1, 2007.

Loan Fees
- Phases the 3% maximum origination fee on FFELP Stafford loans down to 0% by July 1, 2010.
- For FFELP loans guaranteed on or after July 1, 2006, requires the collection, and the deposit into a guaranty agency’s Federal Fund of a federal default fee of 1% of principal, which “fee shall be collected either by deduction from the proceeds of the loan or by payment from other non-federal sources”.
- Phases the 4% origination fee on DL Stafford loans down to 1% by July 1, 2010.

Risk Sharing
- Reduces lender insurance from 98% to 97% for loans for which the first disbursement is made on or after July 1, 2006.

- No change to guarantor reinsurance.

Exceptional Performance
- Provides that lenders and servicers designated as exceptional performers receive 99% insurance.

Section 458 Account/Account Maintenance Fee (AMF)
- For FY 2006, preserves mandatory appropriations for administering the loan programs and for paying guarantors the AMF; caps the amounts at $820 million (this amount has been set at $795 million since FY 2003).
- Beginning in FY 2007, provides that administrative funds other than the AMF are subject to the annual appropriations process.
- AMF payments from FY 2007-2011 continue to be mandatory.
- Eliminates the cap on AMF funds and sets the AMF payment at an amount “not to exceed the basis of 0.10 percent of the original principal amount of outstanding loans”.

Loan Collection
- Beginning October 1, 2006, requires guarantors to remit to the Secretary a portion of the collection fees on default consolidations equal to 8.5 percent of principal and interest, thus effectively cutting retention on those collections to 10 percent.
- Beginning October 1, 2009, prohibits guarantors from retaining any collection fees on default consolidations that exceed 45 percent of the agency’s total collections on defaulted loans.
- Reduces the number of payments needed to rehabilitate a loan from “consecutive payments for 12 months” to “9 payments made within 20 days of the due date during 10 consecutive months”.

School as Lender
- Limits lending to Stafford Loans to graduate and professional students at the school that is acting as lender.
- Provides that all proceeds above administrative expenses, including the proceeds from sales of loans, must be directed to need-based aid.

Grants
- Authorizes “Academic Competitiveness Grants” of $750 and $1,300 to first- and second-year undergraduate students, respectively, and “National Science and Mathematics Access to Retain Talent (SMART) Grants” of $4,000 for third- and fourth-year undergraduate students.

College Access Initiative
- Requires guarantors to provide the Secretary information necessary for the development of web links and access for students and families to a comprehensive listing of the postsecondary education opportunities programs, publications, web sites, and other services in the states they serve. Secretary must ensure the availability of the information provided.
- Requires guarantors to undertake activities to promote access to postsecondary education for students, ensure that required information is available without charge to students and parents, and publicize the availability of the information.
- Guarantors may fund these activities from their operating accounts and restricted account earnings.
- Guarantors not required to duplicate efforts in which they are already engaged that meet the requirements of the College Access Initiative.

Effective Date: Unless otherwise specifically provided, amendments made by the legislation become effective July 1, 2006.

LAO REPORT

The following excerpt is from the Legislative Analyst's Office's (LAO) January 20, 2006 report on the Pending Federal Deficit Reduction Act of 2005: Fiscal Effect on California

Fiscal Effect on California: Pending Federal Deficit Reduction Act of 2005

If enacted by Congress, the Deficit Reduction Act of 2005 would have a significant fiscal impact on California. We project, based on the provisions which we can estimate at this time, that the fiscal impact of this legislation on California would be $3.1 billion—$1.7 billion in reduced federal funds and $1.4 billion in increased state costs-during federal fiscal years 2006 through 2010. These amounts are preliminary estimates and do not reflect potentially significant secondary effects. In this report, we review the major provisions of this legislation, estimate the fiscal impact on federal funds and state funds based on current law, and identify key issues for legislative consideration.

Status of Federal Legislation

On December 19, 2005, the U.S. House of Representatives agreed to the conference committee report for S. 1932, the Deficit Reduction Act of 2005, on a vote of 212-206. On December 21, the U.S. Senate removed certain components from the bill pursuant to Senate rules barring provisions not directly related to the budget, and then sent the amended legislation back to the House for further action. The Senate vote was 51-50 (with Vice President Cheney breaking the tie). House action is tentatively scheduled for the first week of February 2006. If enacted, the measure would have a significant fiscal impact on California. Many of the provisions of this bill would be retroactive to October 1, 2005.

Scope and Methodology for Estimating Fiscal Impacts

Scope of Our Analysis: The pending legislation includes ten separate titles covering a wide range of topics including health and human services programs, student loans, agricultural research, bank deposit insurance, digital television transition, and pension guarantee premiums. We have limited our analysis to Titles VI (health), VII (human services), VIII (education), and IX (low-income home energy). Although other titles may have significant impacts on California residents and businesses, we have focused our review on changes that are likely to either impact state programs or the individuals served by state programs. The fiscal impact on programs falls into two categories: (1) reduced federal funds or (2) increased state costs.

Estimates Based on Current Law: Our estimates are based on current state law, and therefore we do not assume a state backfill of lost federal funds, unless current federal or state law requires such an expenditure. We have estimated the major direct impacts on state and federal funds based on the best available information at this time. Finally, our estimates do not include potential significant secondary impacts.

Preliminary Estimates: Estimating the impact of major federal changes on state finances is difficult because there is substantial uncertainty with respect to how the changes may be implemented. The estimates in this report are based on many sources including the Congressional Budget Office's (CBO's) nationwide estimates for various provisions. To translate CBO's nationwide estimates into California impacts, we needed to make various assumptions. Additionally, given the complexity of the bill and, in some cases, the absence of firm nationwide estimates, the state estimates presented in this report should be considered preliminary and subject to revision as more information becomes available.

Translating From Federal to State Fiscal Years: Our estimates of changes in state and federal funds are presented on a federal fiscal year (FFY) basis which mostly overlap with the state's fiscal years. For example, the fiscal impact in FFY 2007 (October 2006 through September 2007) would mostly overlap state fiscal year 2006-07 (July 2006 through June 2007).

Major Provisions: Below we summarize by program area the major provisions of the proposed Deficit Reduction Act of 2005 (Higher Education sections only):

Existing Law: Currently, the federal government administers various financial aid programs that help students cover college costs. Eligibility for programs is based on financial need as determined by a relatively complicated federal formula. Financial aid includes both grants (such as Pell grants) and loans (such as Stafford loans). Federal loan programs are administered in two ways: direct loans from the federal government, and loans from private lenders that are "guaranteed" by the federal government through a state intermediary agency. The California Student Aid Commission uses an auxiliary agency, EdFund, to process these loan guarantees.

Guaranty agencies such as EdFund play a central role in the administration of the federal guaranteed student loan program. Most importantly, the guaranty agency underwrites the loan, promising to reimburse the private lender if the student defaults on the loan. (This guarantee reduces lenders' risk and thus encourages participation in the program.) The federal government reimburses the guaranty agency (which, in turn, reimburses lenders) when students default on their loans. In addition, loan guaranty agencies attempt to collect from students on defaulted loans. Guaranty agencies and the federal government share the revenue collected on defaulted loans.

In California, EdFund receives funds (in the form of loan fees and incentive payments) from the federal government to administer the program. These funds are deposited in the Student Loan Operating Fund. In recent years, the Operating Fund has run an annual surplus in the tens of millions of dollars. In some years, the state has used a portion of the surplus to help support the state's own financial aid programs, thus creating one-time General Fund savings in those years.

Fiscal Effects of Title VIII: Title VIII of the act makes significant changes to federal aid programs. The changes with the largest fiscal effects are increased borrower interest rates and reduced lender profits-both of which would significantly reduce the amount of federal funding coming to California. These reductions would be partly offset by an increase in certain federal benefits, described below. Based on preliminary CBO projections, we estimate that the combined effect of the various changes would be a net reduction of about $1 billion in federal outlays over the next five years (2006-2010). Although the state budget would not be affected directly, the changes would affect students and their families, lending institutions, and EdFund. Because there is some flexibility in how the various parties can respond to these changes, we cannot estimate how the net costs would be allocated among the three groups. In general, however, we anticipate the following major changes:

- ***Students Would Be Affected in Various Ways.*** Title VIII contains some changes that would benefit students and other changes that would increase their costs. Most significantly, the act creates a new Academic Competitiveness Grant, which would provide additional aid to low-income undergraduates majoring in science, math, technology, and related fields. We estimate that California students would receive a total of about one-half billion dollars in Academic Competitiveness grants over the five-year period. Title VIII also increases the maximum loan amounts that students could borrow and reduces their loan origination fees. Title VIII would also increase some interest rates, however, which would significantly increase costs for some borrowers.

- ***Profits Retained by Lenders Would Be Reduced.*** Title VIII eliminates a federal bonus payment that effectively supplements the interest payments received by lenders from borrowers. Another change would reduce from 98 percent to 97 percent the amount of reimbursement provided to lenders for defaulted loans.

- ***EdFund's Budget Could Be Affected.*** Title VIII makes various loan program changes that could directly and indirectly affect EdFund's loan volume and revenue. Among the largest changes with a direct effect is a new requirement that EdFund collect a 1 percent "default fee." (EdFund currently waives a comparable fee.) This would increase revenue going into a federal reserve fund. EdFund, however, likely would receive less administrative funding from the federal government. Additionally, EdFund's budget would be indirectly affected by changes that influence borrower behavior, such as higher loan limits and interest rates. EdFund expects the combined effect of these changes would be a net reduction in its operating revenue.

Major Provisions Affecting Student Loans in the Higher Education Reconciliation Act of 2005 (Title VIII of the Deficit Reduction Act of 2005 (S. 1932))

Loan Program Reauthorized
• Sunset dates for FFELP extended through FY 2012

Loan Limits
• First- year Stafford limit increases from $2,625 to $3,500
• Second- year Stafford limit increases from $3,500 to $4,500
• Unsubsidized Stafford limit for graduate and professional students increases from $10,000 to $12,000
• Increases annual limit for coursework necessary to enroll in a graduate program or to obtain a professional credential as an elementary or secondary school teacher from $5,000 to $7,000
• Undergraduate and graduate aggregate limits are unchanged
• Loan limit increases take effect July 1, 2007
• Authorizes PLUS loans to graduate and professional students

Interest Rates
• Maintains the scheduled July 1, 2006 change to a fixed interest rate for Stafford and PLUS Loans
• Increases the fixed interest rate for PLUS Loans in the FFELP from 7.9% to 8.5% (through an apparent oversight, the Direct Loan rate is not increased)
• Maintains current fixed interest rate for consolidation loans

Consolidation Loans
• Retains the single holder rule
• Eliminates spousal consolidation
• Eliminates in-school consolidation
• Eliminates reconsolidation in both FFELP and DL, except that a FFELP borrower whose delinquent loan has been submitted to a guaranty agency for default aversion is eligible for a DL Consolidation loan for the purpose of obtaining an income contingent repayment plan
• Provides that a FFELP borrower may consolidate in the Direct Loan Program only if a FFELP lender denies the borrower's application for a consolidation loan or denies the borrower's application for a consolidation loan with income sensitive repayment terms. Additionally, directs the Secretary to consolidate loans of defaulted borrowers
• Provides that, unless otherwise specifically provided, the terms of DL consolidation loans must be the same as FFELP consolidation loans

Loan Fees
• Creates parallel fee structures for FFELP and DL
• Phases the 3% maximum origination fee on FFELP Stafford loans down to 0% by July 1, 2010:

- Lowers to 2% for loans first disbursed on or after 7/1/06
- Lowers to 1.5% for loans first disbursed on or after 7/1/07
- Lowers to 1% for loans first disbursed on or after 7/1/08
- Lowers to 0.5% for loans first disbursed on or after 7/1/09

• For FFELP loans guaranteed on or after July 1, 2006, requires the collection, and the deposit into a guaranty agency's Federal Fund of a federal default fee of 1% of principal, which "fee shall be collected either by deduction from the proceeds of the loan or by payment from other non-federal sources"
• Phases the 4% origination fee on DL Stafford loans down to 1% by July 1, 2010:

- Lowers to 3% for loans first disbursed on or after 7/1/06
- Lowers to 2.5% for loans first disbursed on or after 7/1/07
- Lowers to 2.0% for loans first disbursed on or after 7/1/08
- Lowers to 1.5% for loans first disbursed on or after 7/1/09

• Authorizes the Secretary to reduce the origination fee on DL loans in order to encourage on-time repayment, but only if the Secretary determines the reduction is cost neutral and in the best interest of the Federal Government

Risk Sharing
• Reduces lender insurance from 98% to 97% for loans for which the first disbursement is made on or after July 1, 2006
• No change to guarantor reinsurance
• For loans disbursed on or after July 1, 2006, insurance and reinsurance on exempt claims is set at 100%. Exempt claims are claims on loans where the borrower provided false or erroneous information that caused the borrower to be ineligible for federal benefits

Exceptional Performance
• Provides that lenders and servicers designated as exceptional performers receive 99% insurance
• No other changes to exceptional performance

Repayment Terms
• Requires that DL repayment plans other than income contingent be consistent with FFELP plans

Regular Floor Income
• Provides for capture by the government of interest in excess of the special allowance rate for loans disbursed beginning April 1, 2006

9.5% Floor Loans

• Makes permanent the Taxpayer-Teacher Protection Act provisions that pertain to the elimination of the 9.5% floor; eliminates the exemption for recycling beginning on the date of enactment of the Higher Education Reconciliation Act of 2005

• Delays until December 31, 2010 the effective date of the recycling prohibition for governmental or nonprofit entities not owned or controlled by a for-profit entity that receive the 9.5% SAP on less than $100 million of loans in the most recent quarterly payment prior to September 30, 2005

PLUS SAP Gap

• Limitations on payment of special allowances on PLUS loans made on or after January 1, 2000 are deleted

Disbursement

• Expired provisions which granted disbursement relief for loans to students at schools with low default rates are renewed, effective upon enactment of the legislation

• Requires that the lender or guaranty agency verify the enrollment of students who are studying outside the U.S. in a program of study abroad or at an eligible foreign institution

Section 458 Account/Account Maintenance Fee

• For FY 2006, preserves mandatory appropriations for administering the loan programs and for paying guarantors the AMF; caps the amounts at $820 million (this amount has been set at $795 million since FY 2003)

• Beginning in FY 2007, provides that administrative funds other than the AMF are subject to the annual appropriations process

• AMF payments from FY 2007-2011 continue to be mandatory

• Eliminates the cap on AMF funds and set s the AMF payment at an amount "not to exceed the basis of 0.10 percent of the original principal amount of outstanding loans"

Wage Garnishments

• Increases the amount that guaranty agencies may garnish without the borrower's consent to 15% of disposable pay

Loan Collection

• Beginning October 1, 2006, requires guarantors to remit to the Secretary a portion of the collection fees on default consolidations equal to 8.5% of principal and interest, thus effectively cutting retention on those collections to 10%

• Beginning October 1, 2009, prohibits guarantors from retaining any collection fees on default consolidations that exceed 45 percent of the agency's total collections on defaulted loans

• No other retention cuts

• Reduces the number of payments needed to rehabilitate a loan from “consecutive payments for 12 months” to “9 payments made within 20 days of the due date during 10 consecutive months”

VFAs

• Eliminates the authority to waive the inducement provisions and the required federal default fee in VFAs

School as Lender

• Limits lending to Stafford Loans to graduate and professional students at the school that is acting as lender

• Requires that the lender award any contract for financing, servicing, or administration of Title IV, HEA loans on a competitive basis; offer loans with a origination fee or interest rate below Title IV levels; not have a cohort default rate of more than 10 percent; provide for a compliance audit for any year it serves as lender; and have met the current school-as-lender requirements and made FFELP loans on or before April 1, 2006

• Provides that all proceeds above administrative expenses, including the proceeds from sales of loans, must be directed to need-based aid

Military Deferment

• Provides for a 3-year military deferment for qualifying duty; applies to loans first disbursed beginning July 1, 2001

Forbearances

• Eliminates the requirement that forbearance for serving in certain medical, dental and national service programs, or for borrowers having a Title IV debt burden of over 20%, be in writing, provided the borrower is provided a confirming notice

Loan Discharge

• Loans that were falsely certified as a result of a crime of identity theft are dischargeable

Teacher Loan Forgiveness Benefits

• Eliminates the termination date for the period during which eligible teachers must be new borrowers to qualify for the higher loan forgiveness amount that was authorized by the Taxpayer-Teacher Protection Act of 2004, and ensures that this amendment is not affected by other legislation

• Authorizes loan forgiveness for private school teachers who pass competency tests in applicable grade levels and subject areas

Grants

• Authorizes “Academic Competitiveness Grants” of $750 and $1,300 to first- and second-year undergraduate students, respectively, and “National Science and

Mathematics Access to Retain Talent SMART) Grants" of $4,000 for third- and fourth-year undergraduate students

• To be eligible, a student must be a citizen of the United States, be eligible for a Pell Grant, and meet academic requirements. First- and second-year students must have completed a rigorous secondary school program of study recognized by the Secretary; second-year students must also have earned at least a 3.0 GPA in their first year. Third- and fourth-year students must be pursuing a major in one of several areas related to science, mathematics, or foreign language and have earned at least a 3.0 GPA in the coursework required for their major. Authorizes and appropriates $790 million for FY 2006 and increasing amounts in each succeeding year through FY 2010; provides for ratable reductions in grants to eligible students if the amount made available in any fiscal year is less the amount required

• Establishes an Academic Competitiveness Council of Federal officials to examine and recommend improvements in Federal programs with a mathematics or science focus

College Access Initiative

• Requires guarantors to provide the Secretary information necessary for the development of web links and access for students and families to a comprehensive listing of the postsecondary education opportunities programs, publications, web sites, and other services in the states they serve. Secretary must ensure the availability of the information provided

• Requires guarantors to undertake activities to promote access to postsecondary education for students, ensure that required information is available without charge to students and parents, and publicize the availability of the information Guarantors may fund these activities from their operating accounts and restricted account earnings

• Guarantors not required to duplicate efforts in which they are already engaged that meet the requirements of the College Access Initiative

Eligibility

• Disqualifies students and, in the case of PLUS loans, parents and graduate and professional students, from eligibility for Title IV assistance if they committed a crime involving fraud in obtaining Title IV funds and have not fully repaid those funds

• The suspension of eligibility for students convicted of drug offenses is limited to offenses that occurred while the student received Title IV assistance

Family Contribution and Needs Analysis

• For periods of enrollment beginning July 1, 2007, raises the income protection allowance for dependent students and independent students without dependents (other than a spouse)

• Directs the Secretary to annual revise the income protection allowance tables for parents of dependent students and independent students with dependents, beginning with the 2007-2008 academic year

• For periods of enrollment beginning July 1, 2007, reduces the expected contribution from assets of dependent and independent students
• Expands eligibility for the simplified need test to dependent students who received (or whose parents received), and to independent students who received, benefits under certain means-tested Federal benefit programs
• Expands the first part of the eligibility criteria for the “auto zero” to include dependent students who received (or whose parents received), and to independent students who received, benefits under certain means-tested Federal benefit programs
• Sets the income cap part of the eligibility criteria for the “auto zero” at $20,000
• Active duty members of the armed forces are treated as independent students
• Family controlled small businesses are excluded from assets
• 529 plans and Coverdell education savings accounts are considered assets of the parent

Cost of Attendance

• For less than half-time students, adds the cost of room and board for up to three semesters, of which up to two may be consecutive
• For a student enrolled in a program requiring professional licensure or certification, allows the institution to include the one time cost of obtaining the first professional credentials

50/50 Rule

• Distance education courses are excluded from the rule

Miscellaneous Provisions

• Prohibits a lender from receiving interest on a loan that is disbursed through an escrow agent earlier than three days before the first disbursement
• Requires that a guaranty agency file a claim for reimbursement within 30 days, rather than 45 days, of its discharging its insurance obligation on the loan
• Requires that lender payments into escrow accounts be made not more than 10 days, rather than 21 days, before the date of disbursement to borrowers
• A school’s required return of Title IV funds must be made within 45 days from the determination of the student’s withdrawal

Effective Date

• Unless otherwise specifically provided, amendments made by the legislation become effective July 1, 2006