

## Improving Federal Student Loans for Undergraduates

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The current federal student loan program is too complex, its terms too arbitrary, and its benefits too poorly targeted. The Institute for College Access & Success' white paper, [\*Aligning the Means and the Ends: How to Improve Federal Student Aid and Increase College Access and Success\*](#), proposes a simple, affordable undergraduate loan with a fixed interest rate and no fees. The key features of the proposed loan are designed to reduce complexity, improve targeting, encourage completion, and ensure affordability and predictability for students now and in the future.

**One federal loan for all undergraduate students** in place of today's subsidized and unsubsidized Stafford Loans. A single loan with no fees will be easier for borrowers to understand and keep track of, and for schools and the Department of Education to administer.

**A fixed interest rate that reflects the government's cost of borrowing** to provide predictability to students and ensure that the rates for new loans are in step with the economy. The rate for new loans made each year (e.g., July 1-June 30) would be set based on a U.S. Government-issued security, such as the 10-year Treasury note or the 90-day Treasury bill, plus an additional fixed margin to reflect the cost of the student loan program.

**A lower rate while in school** to increase affordability and encourage students to stay enrolled and complete, knowing that their interest rate will rise when they leave school. While enrolled at least half-time, the interest rate would reflect only the government's cost of borrowing (e.g., if loans were tied to the 10-year Treasury note, the in-school rate for new loans taken out this year would be less than 2%). Upon entering repayment, the rate would reflect the cost of borrowing plus a fixed margin (e.g., if the repayment rate were set at the government's cost of borrowing plus two percentage points, a student with an in-school rate of 2% would have an out-of-school rate of 4%).

**An overall interest rate cap** to ensure that interest rates on student loans will never be too high. A longstanding part of the federal student loan program, a rate cap is an especially important protection for students who enroll in college during periods of high and/or rising interest rates. The cap conveys that federal loans will always be affordable and further distinguishes them from riskier types of credit.

**An interest rate guarantee** to assure borrowers that their rate in repayment will never be too much higher than the rate on new student loans. This will prevent borrowers from being locked into relatively high fixed rates when market rates decline significantly.

- For example, the interest rate guarantee could prevent loans from ever having a rate that is more than two percentage points above the rate on loans being offered to current students. If a borrower has a loan with an out-of-school interest rate of 6.5%, and current students are being offered an out-of-school rate of 3.8%, the borrower's interest rate would automatically drop from 6.5% to 5.8% (two percentage points above the current rate).
- Once it has been lowered, a loan's rate would not rise regardless of economic conditions.
- The cost of this guarantee would depend on the overall rate cap and the specifics of the insurance. The cost would be included in the fixed margin for the out-of-school rate and thus borne by borrowers rather than taxpayers.

**Interest-free deferments for Pell Grant recipients** during periods of unemployment and economic hardship. Pell Grant recipients would be eligible for interest-free deferments on *all* their loans, rather than just their subsidized loans as is this case today, better targeting this benefit to those who need it most, when they need it.