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Subcommittee on Higher Education and Workforce Training

Subcommittee Hearing:
Improving Federal Student Aid to Better Meet the Needs of Students
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Chairman Guthrie, Rep. Davis and Members of the Subcommittee, thank you for the opportunity to appear before you today. As we consider the question of how to improve federal student aid to better meet the needs of students, my testimony provides information about:

- The need to serve more students, better, in the federal financial aid system;
- Recommendations for simplifying further the needs analysis, application and renewal processes for federal student aid;
- Recommendations for consolidating the multiple federal grant and loan programs into a single one-grant, one-loan system, with on-time completion incentives and options for projected savings; and
- Public opinion research for these simplification proposals.

My testimony today benefits from the collective work of experts and colleagues who met between July 2012 and February 2013.[i] Supported by a grant from the Bill & Melinda Gates Foundation, HCM led an expert technical panel focused on offering a cohesive set of options that could put student outcomes at the center of the federal student aid programs, while putting critical aid programs on a more sustainable fiscal path.[ii]

The Need to Serve More Students, Better, in the Federal Student Aid Program

The nation's financial aid system was built for a different age, when access and choice were sufficient programmatic objectives. In 1965, when the first significant federal financial aid program began, 23 percent of Americans had a college degree. That attainment level was sufficient to support a vibrant middle class. That economy and those times are no more. Today, the economy places a premium on postsecondary credentials and the skills those degrees represent. By 2020, 65 percent of all jobs will require some type of postsecondary education.[iii]

Unfortunately, nearly half of all students start college but fail to earn any credential within six years; the outcomes are much worse for African Americans and Hispanics[iv].

Dropout rates of this magnitude were considered a crisis 15 years ago when the nation looked at the rate of high school completion. One reason so many students fail to complete is that our public policies and financing are built on assumptions that no longer hold true. Today's students are older, they juggle work and family while attending school part time, and 47 percent support themselves financially, with 42 percent living in poverty.[v]

A simplified federal financial aid system needs to be seen as part of the solution for a nation that needs many more skilled graduates, a stronger middle class and more opportunity. Each year, the federal government's investment in student financial aid supports nearly $184.1 billion in grant, loan and work-study assistance to more than 20 million students and their families.[vi] Investments in student aid are more than double the spending for any other federal educational program, including Title I of the Elementary and Secondary Education Act (ESEA) and the Individuals with Disabilities in Education Act programs for K-12 schools.[vii] Yet for all of the money it invests, the U.S. government has rarely, if ever, conceived of financial aid as a potential tool to encourage student success in college. *It provides money to (mostly) needy students and hopes for the best.*

In size and scope, student financial aid is more important than ever. Nearly 33 percent of all undergraduates receive a Pell Grant. Nine years ago—before significant increases in the Pell program—revenues from Pell Grants paid almost 20 cents on every $1 received by a college or university in this country. Reliance on Pell funds ranged from 37.7 percent at two-year public colleges to 63 percent at four-year, for-profit private colleges.[viii]

Since 1965, federal policymakers have layered new grant, tax, loan and repayment programs on top of each subsequent reauthorization, budget reconciliation and even emergency spending bill, without stepping back to assess how the pieces work together to accomplish the outcomes currently needed from the programs. Application processes are complex and difficult to understand, particularly for the families who stand to gain the most. Policy discussions traditionally have centered on what it would take to attract and keep private lenders in the program. Student subsidies have been more a matter for program budget development. Even today, loan program subsidies are poorly targeted and cost taxpayers more than necessary to help students manage their repayment obligations and maintain a reasonable debt burden. Eligibility rules don't encourage students to attend full time and finish promptly, and in fact may do the opposite. Participating institutions are held to low

eligibility standards and only rarely lose access to federal aid.[ix] That continued access provides little incentive to contain tuition prices; meanwhile, existing statutes and regulations tend to stunt new approaches and bar program participation by innovative postsecondary education providers.

Recommendations for Simplifying Further the Application and Renewal Processes for Federal Student Aid

The need analysis and application process would be significantly simplified through a three-tiered FAFSA (Free Application for Federal Student Aid) filing system. Applicants in this means-tested program could verify their participation across agencies and access maximum benefits. For most applicants, data sharing with the Internal Revenue Service would pre-fill their application by allowing use of their tax information from two prior years. Students and families with more complex financial situations would submit additional IRS schedules, allowing for aid to be better targeted. A simple app based on income and family size would let students plan early and choose wisely. The need analysis would be based mainly on adjusted gross income (AGI) and family size. It would no longer provide additional aid for families with multiple members enrolled at one point. Together, those changes would encourage more low-income students to file a simplified FAFSA, while targeting federal aid dollars to the neediest students, as reflected in Brookings and the Urban Institute estimates.

Rather than producing a specific value for each applicant's expected contribution, which would establish the grant amount for that student for the academic year, the simplified formula would produce the actual grant amount for that student were she enrolled full time for a full academic year. That contrasts with current practice in which the applicant is not immediately notified of the grant amount for which she is eligible, only that she is eligible for a grant based on the level of her expected family contribution (EFC).

The simplified formula would build on the partnership between the IRS and FSA that allows many FAFSA applicants to retrieve individual tax return income and other financial information directly from the IRS as part of the federal aid application process.

Consolidating the Multiple Federal Grant and Loan Programs into One Grant, One Loan

One Grant Program

The redesigned grant program would merge all existing federal postsecondary grant programs into the Pell Grant program. The Pell program would continue to be focused on the lowest-income students and maintain current initial eligibility standards. Pell Grants could then serve more of today's students, provide them

assistance year-round and offer flexibility in disbursement and other rules so students juggling work and children could access flexible, accelerated learning options and earn credentials.

The one grant program should remove the barriers to on-time completion. Federal law defines full-time enrollment for financial aid as 12 credit hours, which is less than what is generally needed to complete a credential on time. Financial aid recipients must demonstrate "satisfactory academic progress" (SAP) toward degree/program completion beyond the initial year of aid receipt, but the federal government does not mandate specific standards.

With respect to determining a student's enrollment intensity, regulations governing Title IV defer to institutional policy, but with one overarching standard: A student must be enrolled for a minimum of 12 credit hours (or equivalent) to be eligible for a financial aid award available to full-time students. Assuming a 120-credit standard for a bachelor's degree, federal policy does not provide an incentive for students to complete a bachelor's program within four years. At 12 credit hours per semester, it would take a student five years, assuming all classes were passed. While the federal standard is derived from the statutory definition of an academic year, it nonetheless provides no incentive for students to complete their program of study promptly—or for colleges to minimize credit creep in programs, offer core courses when needed or put structured degree pathways in place.

All but three states—Illinois, Minnesota and Washington—similarly cap their foundational need-based state financial aid awards at 12 credit hours. Schools establish their own SAP standards within rather broad federal guidelines.

Promoting more intensive enrollment can improve not only time to degree but also the odds of completion. To encourage on-time progression and completion, the redesigned Pell Grant program should be based on the intensity of students' enrollment, with the maximum grant to first-time students set on the basis of at least 15 credits in each of the first two terms. Afterward, the student could receive the maximum by enrolling in at least 15 credits per term, or by having earned sufficient credit to demonstrate a clear path to on-time completion. For example, a student who earned 33 credits in her first year could be awarded a maximum grant if she enrolled in only 12 semester hours in one term her second year, as long as she earned at least 27 credits in that second year. Students could use summer and other nonstandard terms to increase credits and move toward graduation.

Indiana has added completion expectations in the form of incentives to its primary need-based aid grant programs, the Frank O'Bannon Grant program and the 21st Century Scholars program. The Frank O'Bannon Grant program allows students to earn additional financial aid for completing 30 credits each year in college,

maintaining a cumulative GPA of at least 3.0, earning an associate degree before enrolling in a bachelor degree program, or completing at least 39 or the equivalent credit hours by the end of the first year and 78 or the equivalent credit hours by the end of the second year in college. Recipients of Indiana's 21st Century Scholars are required to maintain this true full-time course load in order to maintain the maximum grant.

The first cohort subject to the reforms has produced some initial encouraging results, including:

- Students receiving state financial aid are taking 30+ credits their sophomore year at higher rates compared with their peers not subject to reforms in both four-year and two-year institutions;
- At four-year institutions, roughly three-quarters of the 21st Century Scholars and two-thirds of Frank O'Bannon recipients met the 30-credit mark;
- At two-year institutions, nearly half the 21st Century Scholars and one-quarter of Frank O'Bannon recipients met the 30-credit mark; and
- Students at both four-year and two-year campuses demonstrated significant gains in meeting the 30-credit-benchmark, but improvement was greater in the two-year sector.[x]

The federal government can adopt incentives in the single grant program that are similar to Indiana's. In 2012, the Brookings Institution and Urban Institute projected for HCM the 10-year savings from the changes, collectively, to a single grant program. These savings, estimated between $86 billion and $120 billion, assuming current grant maximums. Those savings could be reinvested by offering a larger financial incentive for increased course-taking.[xi] For example, the cost of expanding the maximum grant amount to $7,000, coupled with the other single-grant recommendations contained herein, can be done on a revenue-neutral basis.

These figures illustrate what grant amounts would look like at different intensity levels for different grant amounts using our current application system:

With Increased Grant Amounts: $7,000 Maximum and $700 Minimum[xii]

Credits	0 EFC	1,000 EFC	2,000 EFC	3,000 EFC	4,000 EFC	5,000 EFC
15+	$7,000	$6,000	$5,000	$4,000	$3,000	$2,000
12-14	5,600	4,800	4,000	3,200	2,400	1,600
9-11	4,200	3,600	3,000	2,400	1,800	1,200
6-8	2,800	2,400	2,000	1,600	1,200	800

Using Current Pell Grant Maximum and Minimum Amounts[xiii]

Credits	0 EFC	1,000 EFC	2,000 EFC	3,000 EFC	4,000 EFC	5,000 EFC
15+	$5,550	$4,550	$3,550	$2,550	$1,550	$550
12-14	4,440	3,640	2,840	2,040	1,240	
9-11	3,330	2,730	2,130	1,530	930	
6-8	2,220	1,820	1,420	1,020	620	

One Loan Program

The redesigned federal student loan program would collapse the numerous benefits, rules and restrictions under the current program into a single "foundational" loan program. The one loan program would end the 10 different annual and aggregate borrowing limits in the current program and end the various distinctions among the subsidized Stafford, unsubsidized Stafford and Grad PLUS loans, and it would end the Grad PLUS, Parent PLUS and Perkins Loan programs. The single program would set new borrowing limits: one for undergraduate students and one for graduate students. All borrowers would have to repay under a hybrid version of the two existing income-based repayment (IBR) programs. This one-loan system would eliminate much borrower confusion, thus helping students focus on managing college costs, repaying with interest based on actual income, and considering examples of average incomes for their careers when making appropriate borrowing choices. Collectively, a single loan program as proposed here would save nearly $38 billion over 10 years.

More Details from HCM Strategists' technical panel of experts: A Reformed, Default Income-Based Repayment Program

Income-based repayment could mitigate interest rate risk for both borrowers and taxpayers. A borrower's monthly payment would not be based on any particular interest rate or outstanding principal balance on the loan; it would be based solely on his or her income. The interest rate would serve only to determine the speed at which the loan balance was reduced or retired given a certain level of income. Lower incomes would have the same effect as higher interest rates: the reduction in outstanding principal decelerates. Borrowers may pay a bit longer, but they would never pay longer than 20 years (25 years for high-debt borrowers), thus dampening interest rate risk, particularly for struggling borrowers. On the other hand, borrowers with higher incomes would pay back their loans faster under the new income-based plan than they do currently, which would mitigate the risk to taxpayers that the repayment program is overly generous. In essence, the program would be much more self-correcting than the current income-based repayment program, for both borrowers and taxpayers.

The new program would not include any special status features such as in-school interest subsidies, or routine deferment and forbearance options, but it would still allow borrowers to forgo monthly payments while enrolled at least half-time. The

existing suite of benefits is complicated for borrowers to understand, and it requires considerable time and effort for loan servicers and institutions to administer and track. Instead, borrowers would be charged interest while in school. The loss of the deferment and forbearance benefits would be offset by other new benefits. (Income-based repayment allows borrowers to exempt 150 percent of the federal poverty guidelines from their income, thereby providing a form of indefinite deferment or forbearance for borrowers with no or low incomes.) The Congressional Budget Office estimates that provision would save more than $40 billion over the 10-year budget window.[xiv]

A borrower's monthly payment would generally be calculated the same way as the current income-based repayment program in the federal loan system, with several modifications. Under the current plan, a borrower pays 10 percent of his adjusted gross income toward his loan annually (divided by 12 months) after deducting from his income 150 percent of the federal poverty level based on household size. In other words, discretionary income is defined as income in excess of the poverty level-based calculation, and the borrower pays 10 percent of that amount. Today, that deduction for an individual is about $16,500. However, the borrower's monthly payments are also subject to a maximum; they cannot exceed the amount the borrower would pay under a straight-line 10-year amortization plan (the "standard repayment plan"), based on the borrower's loan balance at the time he entered repayment in the IBR plan. That cap makes the current program regressive and allocates benefits to borrowers with higher income in later years. The new IBR suggested here ends the cap and the regressivity it currently creates.

The new income-based repayment program would continue the income deduction based on federal poverty guidelines and maintain the repayment rate at 10 percent of discretionary income, but only for borrowers with incomes below 300 percent of the poverty level appropriate to family size. Borrowers earning more would pay at a rate of 15 percent of discretionary income. That is similar to the structure of the federal income tax: A portion of the taxpayer's income is exempt from taxation—i.e., a standard deduction—and income above that amount is taxed at progressively higher rates. However, in the case of the new IBR plan, there would be just two rates, and borrowers would be subject to one or the other, minus the exemption.[xv]

Borrowers could always opt to pay more per month if they chose. Unpaid interest that was due would accrue, but it would be added to the principal (negative amortization) only after a borrower's debt-to-income ratio fell below a certain point, just like the existing program.

Borrowers who are married, but file separate federal income tax returns, would have to include combined income in the IBR calculation—though the poverty-level deduction would be adjusted to account for household size per the federal guidelines.

In cases where both spouses were repaying student loans, each could base his or her payment on half of the combined household income.

More Details from HCM's technical panel of experts: New Loan Limits
Under the new approach, the current loan system would be replaced by one loan type with an annual limit of $8,750 for all undergraduate borrowers and an aggregate limit of $35,000—i.e., four years of the annual maximum. Graduate and professional students would be subject to an annual limit of $30,000 and an aggregate of $90,000. The total maximum undergraduate plus graduate aggregate limit would therefore be $125,000.

Students would be limited to borrowing for the credit hour equivalent of 150 percent of program length to reduce the number of unneeded courses taken for program completion. The limit would prevent credit creep and encourage institutions and students to focus on clear paths to graduation.

The new loan program would have the same rules regarding maximum award eligibility as the redesigned grant in terms of enrollment intensity. Fifteen credits per semester would be considered full time. First-time students would receive the maximum loan by taking at least 15 credits in both semesters their first year. Subsequently, students must enroll in 15 or more credits per term, or have enough credits to be on a path to on-time completion. For students enrolled less than full time, loans would be issued on a pro-rata basis. As in the current system, students enrolled less than half-time per term would be ineligible for federal loans. Note that those limits are higher than under the current program in some cases (Stafford loans for dependent undergraduates) but lower for others (independent undergraduates, and graduate students because of the elimination of Grad PLUS loans).

Parent PLUS loans would be eliminated. The higher loan limits for dependent undergraduates suggested here would restore some of the borrowing authority for students whose parents would have used the Parent PLUS program. Many parents are also good candidates for obtaining private credit. For students pursuing high-value (high tuition, strong labor market outcomes) undergraduate and graduate programs, new private financing options such as income share agreements can be used, with incentives for financing agreements for low-asset borrowers, including African Americans, Hispanics and Pell Grant students.

Terminating Parent PLUS would help guard against imprudent borrowing and tuition inflation, given that it allowed parents to finance the entire cost of an education, regardless of the tuition.

Graduate students would be eligible for lower limits than the current program because the Grad PLUS program would be eliminated. The annual and aggregate

limits, however, still would be higher than under the current Stafford limits for graduate students. In that regard, the program would end the unlimited borrowing feature of Grad PLUS but allow larger loans than Stafford.

Public Opinion Research for these Simplification Proposals

HCM Strategists, with Hart Research and the Winston Group, polled Americans in 2012 to understand impressions of the postsecondary education system today, the appetite for changes to the system, and reactions to potential financial aid reform approaches aimed at helping address the college completion challenge.

The research was conducted in two phases. First, exploratory qualitative research was conducted among various audiences, including Pell-eligible students, parents of Pell-eligible students, voters, Capitol Hill staffers and education policy leaders. That research then informed the design of quantitative research among engaged voters, African American parents and Hispanic parents. Key findings support the recommendations contained herein[xvi]:

- *Completion of a credential should be the top priority for improving federal student aid policie*s. Engaged voters point to several goals as high priorities for reforming federal and state student financial aid programs, with increasing the number of students who earn a degree/credential (64 percent) at the top. They also put a high priority on making sure that college is affordable, holding students and colleges accountable, and providing both students and colleges with incentives to increase completion. African American and Hispanic parents rank all of these as priorities to some degree. Holding down government spending is not selected as a high priority for reforming financial aid among any audience.

- *Large amounts of student debt—and debt with no degree—needs to be addressed*. About four in five (79 percent) engaged voters say that individuals' amassing large amounts of student loan debt to pay for their college degrees or credentials happens a lot in the United States today, and it ranks in the top two or three biggest concerns (55 percent) among engaged voters. A lesser but still notable 50 percent of voters also say amassing large amounts of student loan debt without completing a degree or credential happens a lot, but they are half as likely to cite it as a top concern (25 percent).

Federal financial aid is the foundation for college affordability in America. Decisions today to simplify the federal financial aid programs and remove the barriers to on-time completion can pave the way for more states, communities, institutions and

employers to build upon this federal foundation and expand affordable pathways for students.

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[i]HCM's technical panel included Dr. Steven E. Brooks, North Carolina State Education Assistance Authority; Kevin Carey, New America Foundation; Kristin D. Conklin, HCM Strategists (chair); Jason Delisle, Federal Education Budget Project, New America Foundation; Dr. Tom Kane, Harvard University; Andrew Kelly, formerly with American Enterprise Institute (now the University of North Carolina System); Daniel Madzelan, retired, U.S. Department of Education, Office of Postsecondary Education (now with the American Council on Education); and Dr. Kim Rueben, Urban Institute and Urban-Brookings Tax Policy Center. HCM Strategists, a public policy and advocacy consulting firm specializing in health and education, led the development of this paper. HCM team members contributing to this project included Lauren Davies, Terrell Halaska, Dr. Kim Hunter Reed and Dr. Nate Johnson. Additional independent data and analyses and draft reviews were provided by the Urban-Brookings Tax Policy Center, Postsecondary Analytics, Hart Research Associates, the Winston Group, Dr. Sandy Baum, Dr. Sara Goldrick-Rab, Arthur Hauptman, Robert Kelchen, Dr. Michael McPherson, Travis Reindl, Kimrey W. Rhinehardt, Celia Simms, Bruce Vandal and Jane Wellman.

[ii] The technical panel's charge and recommendations come from the consensus deliberations of the American Dream 2.0 coalition. Their final report can be found at http://www.americandream2-0.com.

[iii] Carnevale, A. et al. (2013, June). "Recovery: Job Growth and Education Requirements Through 2020." Georgetown University's Center on Education and the Workforce.

[iv] Shapiro, D., Dundar, A., Wakhungu, P.K., Yuan, X., Nathan, A. & Hwang, Y. (2016, November). Completing College: A National View of Student Attainment Rates – Fall 2010 Cohort (Signature Report No. 12). Herndon, VA: National Student Clearinghouse Research Center.

[v] "Today's Student" (2015, September). The Lumina Foundation. https://www.luminafoundation.org/todays-student

[vi] Baum, S. et al. (2016). "Trends in Student Aid 2016." The College Board. https://trends.collegeboard.org/student-aid/highlights

[vii] Delisle, J. and McCann, C. (2012). "How the Pell Grant Program Overtook PreK-12 Educational Programs." 11/14/2012. EdMoney Watch Blog. Washington, D.C: New America Foundation.

[viii] Radwin, D. et al. "2011–12 National Postsecondary Student Aid Study (NPSAS:12)." (2013, August). National Center for Education Statistics. https://nces.ed.gov/pubs2013/2013165.pdf

[ix] Conklin, K. et al. (2015). "Doing Better for More Students: Putting Student Outcomes at the Center of Federal Financial Aid." HCM Strategists, LLC (7).

[x] "Reforming Student Financial Aid to Increase College Completion" (2016, March). Indiana Commission for Higher Education (7).
"Rowing Together" http://www.ecs.org/ec-content/uploads/ECS_FundingReports_HCM_F.pdf

[xi] Appendix: Tables 3 and 4: Savings will depend on additional take-up rate of students from simpler application.

[xii] Table 3 - In practice the student would be able to calculate the grant amount using a formula that subtracts EFC from the Max grant and then multiplies by the intensity of enrollment. We much prefer our simplified system, which would calculate

grant amounts directly based on AGI, number of people in household and course intensity.

[xiii] Table 4 - This policy is roughly equivalent to the 150 percent credit cap proposed for the single loan program.

[xiv] Conklin, K. et al. (2015). "Doing Better for More Students: Putting Student Outcomes at the Center of Federal Financial Aid." HCM Strategists, LLC (16).

[xv] Conklin, K. et al. (2015). "Doing Better for More Students: Putting Student Outcomes at the Center of Federal Financial Aid." HCM Strategists, LLC (17).

[xvi] Hart Associates with David Winston and HCM Strategists, "College Is Worth It" at http://hcmstrategists.com/analysis/462/