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MEMORANDUM OF OPPOSITION

ENACTMENT OF NEW YORK HIGHER EDUCATION LOAN PROGRAM (NYHELPs)

Governor David Paterson has proposed a New York Higher Education Loan Program (NYHELPs) to offer private student loans through the Higher Education Services Corporation (HESC). NYHELPs would be the largest state student loan program in the nation. ***Enacting NYHELPs would be a historic mistake, and we urge the Legislature to reject it.***

- **New York should strengthen TAP instead of cutting TAP and increasing student debt.** NYHELPs isn't free. Its $55 million start-up cost would come at the expense of fully funding and strengthening the Tuition Assistance Program (TAP). Instead of cutting TAP and creating a risky new loan program in the middle of a recession, the state should restore proposed cuts to TAP first. Any remaining funds should strengthen TAP by ending discrimination against younger independent students, who currently qualify for TAP if they earn less than $10,000 annually, compared to $80,000 for all other students.
- **Low-income and minority students need more grant aid, not more debt.** High student debt is riskier than ever in today's rocky labor market, especially for youth without a financial cushion to fall back on. Financial aid experts recommend that low-income students who must borrow take out only small federal loans, which come with guaranteed borrower protections absent from NYHELPs and other private loans.
- **NYHELPs sets up New York to compete with a safer federal loan program.** New York should seize the opportunity to promote the federal Parent PLUS loan program for college students. Yet NYHELPs would drive New York into competition with PLUS, forcing the state to take on costs and risks that the federal government has offered to bear, and exposing families to unnecessary financial risks. While PLUS does not cover students whose parents decline to borrow on their behalf, NYHELPs requires such students to provide a creditworthy cosigner – and few non-parent relatives or friends are likely to volunteer.
- **NYHELPs lacks key consumer protections that are included in the federal loan programs.** NYHELPs would enable college students to borrow up to $50,000, far more than most graduates could repay after leaving college. If they default, HESC could garnish wages, confiscate tax refunds, and charge unlimited fees. In fact, NYHELPs lacks key consumer protections common to federal loan programs, such as income-based loan repayment and interest-rate caps.
- **NYHELPs puts taxpayers at risk.** NYHELPs relies on "default reserve pools" to pay for delinquencies and defaults. There is no explicit taxpayer guarantee to maintain the solvency of these pools. The federal government was forced to bail out Fannie Mae to protect its credibility in financial markets despite the absence of an explicit guarantee. New York would face similar pressures in the event of a NYHELPs insolvency.

Should you have further questions, please contact Thomas Hilliard, Senior Policy Associate, at (518) 463-1896, ext. 38 or thilliard@scaany.org.

March 17, 2009

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TEN CONCERNS ABOUT NYHELPs

I. **New York should strengthen TAP instead of cutting TAP and increasing student debt.** NYHELPs isn't free. On the contrary, its $55 million start-up cost would come at the expense of fully funding and strengthening the Tuition Assistance Program (TAP). The Executive Budget proposes cutting TAP by $65 million, including a proposal to slash aid to students taking less than 15 credit hours per semester by up to 20% – a $1,000 cut to some students. Given the struggles of low-income and minority young people in the current recession, the state should start by restoring cuts to TAP first. Any remaining funds should be used to strengthen TAP by ending discrimination against younger independent students. At present, independent students without dependents only qualify for TAP if their income falls under $10,000, compared to $80,000 for all other TAP recipients. Furthermore, they only qualify for a TAP grant of $3,000, compared to $5,000 for all other TAP recipients.[1] Yet these are precisely the young people who most urgently need education and skills training in a deep recession.

II. **Low-income and minority students need more grant aid, not more debt.** High student debt is riskier than ever in today's rocky labor market, especially for youth without a financial cushion to fall back on. Financial aid experts typically advise low-income students not to take out loans at all.[2] Default rates on federal loans are historically high for some groups, such as African-Americans (39% default rate), Hispanics (15%), graduates with low starting salaries (20%), and graduates with loan balances of $15,000 or more (17%).[3] Delinquencies and defaults are rising in today's economy, as college graduates struggle to navigate a slack labor market. Financial aid experts advise those low-income students who must borrow to stick with federal loan programs.

III. **Borrowers with the fewest financial resources will pay more for NYHELPs loans.** HESC plans to charge higher borrower fees to students with a high default risk – up to 8%, equivalent to adding another 2% to the interest rate.[4] Default risk is usually calculated on the basis of FICO scores and attendance at schools with low graduation rates. Since low-income and minority families are much more likely than other families to have low FICO scores, they are likely to pay more for their student loans.[5]

IV. **NYHELPs sets up New York to compete with a safer federal loan program.** The federal Parent PLUS loan program offers fixed-rate loans to all dependent students at reasonable interest rates (7.9% or 8.5%), with no loan cap or income test. New York should seize the opportunity to promote PLUS for college students, just as we promote Food Stamps and other federally funded programs. NYHELPs would drive New York into competition with PLUS, forcing the state to take on costs and risks that the federal government has offered to bear. "Given current interest rates," says a HESC document, "NYHELPs will likely offer variable interest rates lower than PLUS fixed-rates."[6] Despite HESC's claims to the contrary, this statement strongly implies that HESC intends to challenge a federal loan program, and to do so in a way that could exploit students. Interest rates are near historic lows right now. They are likely to rise sharply over time, piling unexpected costs on college graduates who opt for a variable-rate NYHELPs loan.

V. **The gap in federal loan programs is smaller than most New Yorkers realize**. HESC argues that the proposed loan program would fill the unmet need left behind after federal and private loan programs. But the combination of Stafford and Parent PLUS can meet the needs of almost all undergraduate students. Many college students taking out private loans today are failing to take full advantage of federal loan eligibility, a serious problem that New York really should address.

VI. **NYHELPs fails to fill most of the remaining gaps in federal loan programs.** It is true that dependent students cannot receive PLUS unless their parents agree to take out the loan. But NYHELPs does not fill this "parental refusal" gap. The requirement in NYHELPs that students provide a creditworthy cosigner mimics PLUS, since the cosigner has all the repayment responsibilities of a parent who takes out the loan directly. In practice, the population of non-parent relatives willing to stake their financial wellbeing on cosigning a student loan is likely to be extremely small. It has also been proposed that NYHELPs could provide loans to independent students, who are ineligible for PLUS loans. But the federal government has arranged for independent students to qualify for $57,500 in Stafford loans, a loan cap far in excess of what most independent students can prudently repay.

VII. **NYHELPs lacks key consumer protections that are included in the federal loan programs.** The proposed program would enable college students to borrow up to $50,000, far more than most students could repay after leaving college. If they default, HESC could garnish wages and confiscate tax refunds, powers not granted to any other private loan program. At the same time, NYHELPs lacks key consumer protections common to federal loan programs, notably repayment options for students going into public-service occupations, loan cancellation for students attending fraudulent or insolvent schools, and interest-rate caps for the variable-rate loan product.

VIII. **Providing financial literacy education is not a significant consumer protection.** HESC will require that student borrowers complete a computerized financial literacy education course. There is nothing inherently wrong with providing such instruction. However, studies have repeatedly found little evidence that financial literacy education improves financial decisionmaking.[7] Furthermore, HESC receives up to $25 for each NYHELPs loan processed through its Student Loan Marketplace. Allowing an agency with a financial stake in writing new loans to oversee an educational program for prospective borrowers creates an inherent conflict of interest.

IX. **NYHELPs' financial model is a risky one.** NYHELPs does not appear to be a robustly competitive program. Should market or budget conditions change, NYHELPs may be priced out of the student loan market. In particular, NYHELPs proponents have expressed a desire to assist students with low credit scores who experience increasing difficulty accessing the private loan market. NYHELPs may be able to provide a significant alternative to the private loan market for these students (although it remains unclear how many would be better served by federal loans). But there is a catch: private lenders backed away from lending to these students because their high default rate led to massive losses. If these students flock to NYHELPs in large numbers, NYHELPs' default reserve pools could experience significant losses.[8]

In addition, colleges may opt not to participate in NYHELPs when credit markets rebound, since they must pay a 1% fee on loan volume. The state could reduce the $10 million subsidy in the future, thereby driving interest rates up further. Finally, necessary borrower protections (such as an income-based loan repayment option) may not be compatible with NYHELPs' fiscal model.

X. **Taxpayers are exposed to the risk of a NYHELPs insolvency.** NYHELPs relies on "default reserve pools" to pay the costs of delinquencies and defaults. These pools are not taxpayer-guaranteed, and NYHELPs' proponents argue that the state would have no obligation to bail them out in the event of insolvency. Yet the federal government was forced to bail out Fannie Mae to protect its credibility in financial markets despite the absence of an explicit guarantee. New York would face similar pressures in the event of a NYHELPs insolvency.

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[1] For more ideas on improving TAP to serve the needs of working and unemployed adults, see SCAA's *Working to Learn, Learning to Work: Unlocking the Potential of New York's Adult College Students*, August 2007.

[2] Sandy Baum and Saul Schwartz, *How Much Debt is Too Much? Defining Benchmarks for Manageable Student Debt*, College Board, 2006, p. 11: "[S]tudents from low-income families seem likely to have greater difficulty than others managing any given debt burden."

[3] Susan P. Choy et al, *Dealing With Debt: 1992-93 Bachelor's Degree Recipients 10 Years Later*, National Center for Education Statistics, June 2006. Also see Erin Dillon, "Hidden Details: A Closer Look at Student Loan Default Rates," Education Sector, October 27, 2007. Default rates are measured for bachelor's degree graduates over the 10-year period from 1994 to 2003.

[4] Higher Education Services Corporation, "NYHELPs Q&A," handout, undated, p. 3.

[5] Testimony of J. Robert Hunter, Director of Insurance, Consumer Federation of America, Committee on Financial Services, U.S. House of Representatives, May 21, 2008, p. 22.

[6] Higher Education Services Corporation, "NYHELPs Q&A," handout, undated, p. 6.

[7] Lauren E. Willis, "Against Financial Literacy Education," *Public Law and Legal Theory Research Paper Series,* University of Pennsylvania Law School, March 20, 2008.

[8] Fitch Ratings, *Private Education Loans: Time for a Re-Education*, January 28, 2009, p. 7. The largest student lender, Sallie Mae, reported that in the fourth quarter of 2008, students with "a lower tier credit rating, low program completion and graduation rates, or, where the borrower is expected to graduate, a low expected income relative to the borrower's cost of attendance," resulted in net losses of 16.1%, compared to net losses of 2.5% among all other borrowers.