Inside Higher Education
New Ideas on Interest Rates

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WASHINGTON -- With just over seven weeks remaining until the interest rates on some federal student loans are set to double, Republicans in the House of Representatives introduced legislation to avert the increase and change how student loan interest rates are determined.

The legislation, the Smarter Solutions for Students Act (H.R. 1911), would tie the interest rate for federal student loans to the interest rates on 10-year Treasury notes, meaning the rate would vary with the market. Rates would also vary over the life of the loan: borrowers' interest rates, and monthly payments, would change from year as they repay the loan.

Right now, interest rates on federal student loans are set by Congress as part of legislation passed in 2007. If Congress doesn't act by July 1, the interest rate for subsidized Stafford loans -- which don't accumulate interest while students are enrolled in college -- will increase from 3.4 percent to 6.8 percent. The 2007 legislation had gradually lowered the rate from 6.8 percent that year to 3.4 percent in 2011 -- and timed it to shoot up again last year to 6.8 percent once more. But students lobbied hard against the change, President Obama's re-election campaign seized on the issue, and Congress extended the 3.4 percent rate for an additional year, until July 1 of this year.

This year, both the Obama administration and House Republicans are pushing for a long-term solution based on interest rates in the broader economy. Senate Democrats are more skeptical -- meaning that the fate of the measure could rest on whether the House legislation introduced Thursday could pass with broad bipartisan support and overcome opposition within the president's own party.

Several other interest rate proposals are already on the table. President Obama's, included in his budget request for fiscal year 2014, would also tie interest rates to 10-year Treasury bonds. Senate Republicans have introduced a bill similar to the president's plan. And two Senate Democrats introduced their own plan Thursday, which would create a variable interest rate tied to the 91-day rate on Treasury bonds.

The House Republican plan would set interest rates for all Stafford undergraduate loans at the 10-year Treasury yield plus 2.5 percentage points; for PLUS loans, the 10-year Treasury yield plus 4.5 percentage points. Stafford loans issued today under the plan would have an interest rate of 4.3 percent, lower than the current interest rate for unsubsidized student loans (and higher than the 3.4 percent interest rate for subsidized loans).

The interest rate formula varies slightly from the administration and Senate Republican proposals (see chart below). But the House Republican plan has two bigger differences. It would create a truly variable interest rate -- one that resets each year over the life of the loan -- for the first time since 1992. And interest rates would be capped so they couldn’t rise indefinitely with the market. For Stafford loans, the highest possible interest rate would be 8.5 percent; for PLUS loans, 10.5 percent.

Neither Obama’s plan nor the Senate Republican proposal included an interest rate cap. Since those proposals were first put forward, student advocates have argued strongly in favor of capping interest rates, and some House Democrats seemed sympathetic to their arguments. They’ve warned that if interest rates increase to the historic highs of the 1980s, students could be forced to take out loans with interest rates above 15 percent. But the Obama administration sees its expanded income-based repayment program, which ties borrowers' repayment to their discretionary income and forgives the debt after 20 years, as the best way to ensure that borrowers can afford their loan payments.

An Unusual Alliance

While the White House and Congressional Republicans have said they want a long-term fix for the interest rate problem now, many Senate Democrats are said to prefer a short-term extension of the 3.4 percent rate on subsidized Stafford loans.

The Higher Education Act is up for renewal next year, and members of the Democratic leadership in the Senate view that legislation as the natural place for an interest rate fix. Senator Tom Harkin, chairman of the Committee on Health, Education, Labor and Pensions, is said to be working on a bill -- with the support of the majority leader Harry Reid -- that would extend the 3.4 percent rate for another two years on subsidized Stafford loans.

The measure would cost $8.3 billion, and lawmakers are still determining how to pay for it, lobbyists and other observers here said Thursday.

Meanwhile, two other Democratic senators -- Jack Reed of Rhode Island and Dick Durbin of Illinois -- introduced their own interest rate bill Thursday. That bill, the Responsible Student Loan Solutions Act, would tie the interest rate on student loans to the rate on a 91-day Treasury bill, plus an additional percentage to cover the cost of administering the loans. The U.S. education secretary would determine how much to add. As in the House Republican proposal, rates would vary from year to year over the life of the loan.

Senator Elizabeth Warren, a Massachusetts Democrat, also introduced a proposal Wednesday to have the Federal Reserve fund student loans and charge the same interest rate as it does for banks -- 0.75 percent.

As those options proliferate, the July 1 deadline is approaching. Colleges will begin originating loans for the fall semester not long afterward. If the rate is allowed to double, Congressional Republicans will likely lose their appetite for addressing the issue, said a Senate staffer -- in part because students won’t feel the impact right away.

The many options, and the apparent disagreement among Senate Democrats and the White House, mean that the fate of the bill could rest on whether the House measure can pass with bipartisan support and be amended in the Senate. And it puts the Obama administration in the unusual position of being allied most closely with Congressional Republicans, usually its staunchest opponents.

“Republicans have been working to provide stability for a long time and it appears from the President’s budget proposal that he also sees the need to remove the whims of Washington from the student loan equation,” Representative Virginia Foxx, chairwoman of the House Committee on Education and the Workforce's subcommittee on higher education and training, said in a statement. “We hope to build off that common ground."

Read more: http://www.insidehighered.com/news/2013/05/10/student-loan-interest-rate-proposals-house-republicans-and-some-senate-democrats#ixzz2gb9XJE6m
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The proposals so far:

	Current law	**Obama's FY14 budget request**	**House Republicans (H.R. 1911)**	**Sens. Reed and Durbin**	**Sen. Elizabeth Warren**
Interest rate determined...	By Congress. Interest is 3.4% on subsidized Stafford; 6.8% on unsubsidized Stafford; 7.9% on PLUS loans.	10-year Treasury rate plus 0.93 percentage points for subsidized Stafford; plus 2.93 points for unsubsid-ized Stafford; plus 3.93 points for PLUS loans.	10-year Treasury rate plus 2.5 percentage points for unsubsid-ized and subsidized Stafford; plus 4.5 points for PLUS loans.	91-day Treasury rate plus a percentage determined by the Education Secretary to cover administra-tive costs.	By the discount rate the Federal Reserve charges to banks, at least for one year.
Interest rate varies over life of loan?	No.	No. Rate varies from year to year for new loans, but is then fixed for life of loan.	Yes.	Yes.	No.
Interest rate cap?	N/A	No.	Yes: 8.5% for Stafford loans; 10.5% for PLUS.	Yes: 6.8% for subsidized Stafford, 8.25% for unsubsidized Stafford and PLUS.	N/A
If a new loan was issued today under this plan, interest rates would be...	3.4% for subsidized Stafford, 6.8% for unsubsidized Stafford, 7.9% for PLUS	2.74% for subsidized Stafford; 4.74% for unsubsid-ized Stafford; 5.74% for PLUS	4.31% for subsidized and unsubsid-ized Stafford; 6.31% for PLUS	Unclear what administra-tive costs would be. 91-day Treasury yield is .04%	0.75%.