REPUBLICAN + EDUCATION POLICY
rpc.senate.gov
@Senate_RPC
JOHN BARRASSO, M.D.
CHAIRMAN, SENATE REPUBLICAN POLICY COMMITTEE

June 28, 2012

Student Loan Interest Rate Extension

Senate Republicans and Democrats have reached an agreement, attached to the *Highway Bill (H.R. 4348)*, to extend current student loan interest rates. The extension applies to students who are still in school, and ultimately, graduate from college during these difficult financial times. Last year 1.5 million or 53.6 percent of recent college graduates were jobless or underemployed.

Federal Student Loan Types and Interest Rates

There are two types of federal Stafford Loans for college students—subsidized and unsubsidized.

Subsidized Stafford Loans: Need-based and only available to undergraduate students. Borrowers with subsidized loans are not charged interest on the loan as long as they are (1) enrolled in school at least half-time, (2) during the grace period after graduation, and (3) during loan deferments.

Unsubsidized Stafford Loans: Not need-based and are available to both undergraduate and graduate students. Borrowers of these loans accrue interest on the loan immediately. They can pay down the interest while in school, as well as during grace and deferment periods, or they can allow the interest to accrue and be capitalized.

The 2001 reauthorization of the Higher Education Act (HEA) of 1965 established a fixed 6.8 percent interest rate for both subsidized and unsubsidized Stafford Loans beginning in 2006. In trying to cut the rates in half, legislators realized a permanent interest rate reduction would be too costly. Congress therefore passed legislation to phase-in a temporary reduction in the interest rate for the subsidized Stafford Loans over a four-year period:

> 2008-2009 school year loans were at 6 percent;
> 2009-2010 school year loans were 5.6 percent;
> 2010-2011 school year loans were 4.5 percent; and
> 2011-2012 school year loans were at 3.4 percent.

Unsubsidized Stafford loans have been disbursed at the 6.8 percent interest rate since 2006, and without Congressional intervention, the unsubsidized loans will revert to the 6.8 percent rate on July 1, 2012.

Paper Trail to Agreement

The average student borrows $3,658 per year to pay for college tuition. Extending the 3.4 percent interest rate on newly originated subsidized Stafford Loans for one year would save the average borrower $6.91 a month when loan repayment begins.

On May 24, the Senate voted on both the Republican and Democrat proposals for extending the current interest rate on subsidized Stafford Loans. The Democrat proposal, *Stop the Student Loan Interest Rate Hike of 2012* (S. 2343), would have imposed a payroll tax increase on certain small businesses by changing how S-Corporations' income is classified and failed 34-62-1. The Republican proposal, *The Interest Rate Reduction Act* (S. 2366), would have repealed the remaining funds in the President's health care law's Prevention and Public Health Fund. It failed 51-43-1. Since both measures were rejected, on May 31, Senate and House Republican leadership sent a letter to President Obama with alternative offset options. The President never responded to the Republican letter, but Majority Leader Reid sent an alternative offset proposal.

The resulting agreement combined offsets that were included in both the Republican and Democratic offers.

Changing the Subsidized Loan Eligibility

Under current law, there is no limitation on how long students remain eligible for the interest rate subsidy as long as the borrower remains in school. The bipartisan proposal would change that by eliminating the subsidy for students who do not graduate from the program within 150 percent of the normal time allotted to complete the program. The practical effect of this would be that borrowers attending 4-year programs, but who do not graduate within six years, will no longer be eligible for the interest subsidy on the loans they have already taken out. This means the loans will begin accruing interest immediately. The borrowers also would not be eligible for the lower interest rate on any newly originated loans to pay for attendance beyond those six years. The change will only apply to new student loan borrowers.

This proposal was in the President's budget, was one of the offsets included in the House and Senate Republicans letter to the President, and was included in Senator Harkin's Labor-HHS-Ed Appropriations bill. It will raise $1.2 billion.

Indexing Pension Benefit Guarantee Corporation Premiums

The Pension Benefit Guaranty Corporation (PBGC) was created in 1974 and currently guarantees the retirement income of more than 44 million private-sector workers with defined benefit pension (DB) plans. A DB plan provides a guaranteed specified monthly retirement benefit that is usually based upon on individual's salary and years of service. While the PBGC is government owned, general tax revenues do not fund it. It is funded, among other things, through the insurance premiums it collects from employers who offer DB plans. These premiums are established by Congress and, in part, ensure that when a company terminates a DB plan and cannot pay 100 percent of the promised benefits to its employees, those individuals still receive a monthly retirement benefit, up to a guaranteed maximum.

The bipartisan agreement would index variable rate PBGC premiums to inflation starting in 2013. The new revenue will be used to both offset the projected PBGC deficit and pay for the one-year student loan interest rate extension. It is estimated to save $10.6 billion over 10 years.

Stabilizing Pension Contributions

Under the Pension Protection Act of 2006 (PPA), employers are required to adequately fund DB plans by ensuring that the amount in the DB plan will be enough to pay future liabilities. This is determined by assuming the fund earns a certain amount of interest over time and is calculated using the average interest rate of corporate bonds over the past two years. Because interest rates have been abnormally low, companies have had to make higher annual contributions to pension plans because the lower interest rates assumes a high balance is required to fund the plan.

In the Senate-passed Highway bill (S. 1813), which received 74 votes, there was a provision that provided relief by allowing employers who offer their employees a DB plan to use an average interest rate within a 10 percent window above or below the average of corporate bond rates over the past 25 years. This would minimize fluctuations in the required annual plan contributions, ultimately meaning lower required contributions for 2012 and 2013. This provision would raise revenue because employers making lower DB plan contributions will receive lower corporate income tax deductions, which will increase federal tax revenue. The provision will raise approximately $9.4 billion over 10 years.

The Final Deal

The final conference agreement does not explicitly designate offsets for particular programs. Therefore, while the discussions on how to pay for the student loan interest rate extension revolved around these three proposals, the reality of including them in the Highway Bill conference report is that no offset is tied to any particular policy. This means that the pension offsets may not specifically pay for the student loan extension, even though the extension is paid for by one of the offsets included in the conference agreement.