Effects of the New Legislation

By Shaileja Mammen

President Bush has agreed to sign The College Cost Reduction Act of 2007 despite his initial opposition to it and fear that it will bring far-reaching changes to federal student loan programs.

The legislation was the result of widespread dissatisfaction with the practices adopted by student lenders to acquire more student loan business.

The changes, effective October 1st, include elimination of $22.32 billion in subsidies for for-profit lenders; 50% reduced interest rates on need-based loans; an increase in Pell Grants to $5,400 per year; and loan forgiveness after 10 years for students if they become law enforcement officers, firefighters, nurses, public defenders, librarians, or early childhood teachers.

Some of these changes will result in:

- reduction of competition among student lenders
- reduction of benefits, such as discounts on fees and interest rates, for student borrowers
- reduction of profitability from student loan business
- layoffs at student lending organizations
- an increase in loan origination fees and late fees
- an increase in penal charges and interest on defaulted loans
- reduced discounts on loan consolidations

Student lenders that were heavily dependent on federal subsidy will be affected the most. This will force student lenders to find profitable ways to replace the subsidies.

Nonprofit lenders, however, are not under pressure to demonstrate profits to shareholders, and they do not they have to worry about capital flowing out of their student lending businesses. This is because some of them use tax-exempt bonds to finance student loans that will not be affected by the new legislation; thus, their products will remain unchanged in terms of fees and interest rates.