PRIVATE LOAN COUNSELING FOR UNDERGRADUATE STUDENTS: THE ROLE OF COLLEGE FINANCIAL AID COUNSELORS

by

Carol A. Jensen

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PRIVATE LOAN COUNSELING FOR UNDERGRADUATE STUDENTS:

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Carol A. Jensen, Ph.D.

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Adviser: Donald F. Uerling

The cost of attending college has surpassed federal financial aid limits and fewer parents are paying the balance. As private lenders have been targeting undergraduate students to obtain private (alternative) loans to fill the financial gap, many students do not have parents or other adults to help them navigate one of the largest financial investments they will ever make.

Financial aid counselors, more than anyone else on campus, are in a position to discuss quality consumer loan information with students and families. Federal financial aid requirements for counseling undergraduate students on federal student loans do not pertain to private student loans. This qualitative study examined the role of college financial aid counselors regarding private loan counseling for undergraduate students.

Participants in the study were 20 financial aid counselors at 4-year public and 4-year private, not-for-profit, colleges and universities located in 12 Middle West region states. The participant counselors were interviewed about their past and present private loan counseling practices, the reasons more undergraduate students obtain private loans, the differences between private loans and federal student loans, their perceptions of

counseling effectiveness and counseling limitations, and their recommendations for counseling students about private loans.

There were five major findings: (a) participant counselors believed that the 2007 Slate Act significantly limited their ability to counsel students on private loans; (b) many undergraduate students do not read or do not comprehend the written and online information counselors provide on private loans; (c) more parents are not willing or are unable to pay college costs; (d) counselors believed that one-on-one private loan counseling for students would be more effective than their current ‘surface’ counseling practices; and (e) many students and parents do not fully grasp the differences between private and federal student loan options.

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CHAPTER ONE

INTRODUCTION

The purpose of college financial aid for undergraduate students is to ensure those students have sufficient resources to enable them to attend college. Financial aid funds are provided to help with all costs of attending college, including costs of tuition, enrollment fees, books and supplies, room and board, transportation, computers, and some living expenses while in college. Colleges design financial aid offices and hire financial aid counselors to offer an array of financial support services and to assist undergraduate students with the entire financial aid process. Student loan opportunities, scholarships, and grants are available to college students who complete the application process and qualify. Eligible students are awarded financial aid through a variety of types of programs on a first-come, first-serve basis, as funding is available. Applicants are monitored for continued eligibility based on academic progress, available funds, and enrollment status (Financial Aid Glossary, 2008, p. 8).

Financial aid counselors have long played an important role in financing postsecondary education and certifying student financial aid up to the cost of attendance (COA). As stated within the National Association of Student Financial Aid Administrator's ethical statement, the primary goal of the financial aid counselor is to help students achieve their educational potential by providing financial resources. Counselors are committed to remove financial barriers for students who work to pursue postsecondary learning, to make every effort to assist students with financial need, and to educate students through quality consumer information (NASFAA, 2003, p. 1).

While the total cost of a college education has increased, financial aid offices face greater challenges as counselors package financial aid for college students. Financial aid trends show that when the combination of available grants, scholarships, federal student loan limits, and expected family contributions falls short of meeting many students' total financial needs, a growing number of students turn to private loans to fill the financial gap. Private loans are now the fastest growing component of student financial aid. Financial aid counselors are an instrumental and influential group within this escalating postsecondary challenge. Aid counselors balance their duty to encourage responsible debt management with the need to meet varying student demands and college enrollment goals. Financial aid offices counselors are held accountable through audits by the federal government to certify that the combination of all student financial aid, whether federal or private, does not exceed the total cost of attendance (Wegmann, Cunningham, & Merisotis, 2003, p. 39).

When undergraduate students and their parents began to find the process of obtaining federal student loans as slow and tedious, and when the combined federal loan options failed to meet the increasing financial demands of dependent college students, the private student loan industry boomed. Private lenders found this as an opportunity to niche market direct private loan options to fill the financial gap. Private loans even helped students attend the schools they wanted to attend rather than attending another school because of their inadequate financial resources. So while private loans helped students stay enrolled in the colleges of their choice, filled the gap for students' financial needs, and helped colleges meet enrollment goals, they also created problems when it

came to developing financial aid counseling methods for undergraduate students who obtained private loans. Some financial aid counselors, as well as the students, did not have a clear sense of either the amount or the type of private loans that were being obtained. In some cases, financial aid counselors were unaware that undergraduate students were even obtaining private loans. Unlike federal student loans, where entrance and exit counseling procedures have been required and have basically become standardized, the diversity of private student loans created problems for counselors when it came to providing private loan counseling and developing standard counseling methods for private loans (Wegmann et al., 2003, p. 44).

The need for undergraduate college students to have access to clear, unbiased consumer information will only become more important and more challenging as total federal loan limits remain relatively unchanged and the private loan market offers diverse credit-based private loan products. Meeting students' needs for information on the wide array of college financing options will continue to challenge financial aid counselors and their counseling methods.

While many financial aid offices have found some ways to streamline the private loan process for students, the majority of these same offices struggle with how to provide counseling on private loans.

Purpose Statement

Financial aid counselors, more than anyone else on campus, are in a position to responsibly advocate for students' financial interests and to discuss quality consumer information with students and families. The cost of attending college has surpassed

federal financial aid limits, and fewer parents are paying the balance. While private lenders have been targeting undergraduate students to obtain private (alternative) loans, many students do not have parents or other adults to help them navigate one of the largest financial investments they will ever make. Private loans are the fastest growing component of student financial aid as more students have resorted to credit-based private loans to fill the financial gap (American Council, 2007, p. 1).

There are no academic standards for counseling undergraduate students on private loans (Wegmann et al., 2003, p. 78). The U. S. Department of Education has no authority or jurisdiction over private loans. Federal financial aid requirements for counseling undergraduate students on federal student loans do not pertain to private student loans (N. Girardi, personal interview, 2008).

The purpose of this study was to determine what role college financial aid counselors have in counseling undergraduate students on private (alternative) student loans. Counselors were interviewed about their past and present private loan counseling practices, the reasons more undergraduate students obtain private loans, the differences between private loans and federal student loans, their perceptions of counseling effectiveness and counseling limitations, and their recommendations for counseling students about private loans.

Definition of Terms

Cost of attendance—the total costs of tuition, room and board, transportation, textbooks, computer, class fees, and miscellaneous school fees.

Credit checks—a record of an individual's or company's past borrowing and repaying, including information about late payments and bankruptcy.

Direct-to-consumer private loans—(also called DTS, Direct-to-Student loans) - private loans to finance a college education that are marketed directly to the students and their parents (consumers).

Entrance counseling—required federal loan counseling session to help college students develop a budget for educational expenses and loan responsibilities.

Exit counseling—required federal loan counseling for students on their financial rights and responsibilities prior to graduating or exiting college.

FAFSA (Free application for federal student aid)—application used by most colleges and universities to determine eligibility for federal, state, and college-sponsored financial aid, including grants, educational loans, and work-study programs.

FICO—Fair Isaac Corporation credit scoring system that measures credit risk.

Fixed interest rate—interest rate on a loan that is fixed and does not change until maturity.

Grace period—timeframe when no payments are due.

Interest—charge for borrowing money.

Lending limits—the maximum amount of loan(s).

LIBOR—an interest rate at which banks can borrow funds, in marketable size, from other banks in the London interbank market.

Parent PLUS—credit-based loan available for parents to cover full cost of attendance minus any other aid the student has received.

Partnership loan—Iowa-based student loan through the Iowa Student Loan Liquidity Corporation.

Perkins loan program—federal program that provides low-interest loans to help needy students finance the costs of postsecondary education.

Prime rate—variable rate index of the rate charged by major banks to their most creditworthy customers.

Principal—the amount borrowed, or the part of the amount borrowed which remains unpaid (excluding interest).

Private loans—unsecured, credit-based loans available to students for tuition and fees, room and board, school supplies, computers, and other education related expenses.

School-channel private loans—loans from private lenders that are certified by the school.

Stafford loan—common federal loan used to finance education, both subsidized and unsubsidized.

Subsidized—Stafford loan where the government pays interest while student is in school.

Undergraduate students—students pursuing a 4-year bachelor's degree.

Unsubsidized—Stafford loan for which the government does not pay interest.

Variable interest rate—interest rate on a loan that increases or decreases based on the movement of an underlying index of interest rates.

Delimitations and Limitations

This study is delimited to financial aid counselors at 4-year private, not-for-profit, and 4-year public colleges and universities.

This study is delimited to 4-year private, not-for-profit, and 4-year public colleges and universities located in Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, Ohio, Nebraska, North Dakota, South Dakota, and Wisconsin.

This study is delimited to the perceptions of participant counselors who advise undergraduate students about private loans.

This study is limited to information obtained in telephone interviews.

This study is limited to a purposeful group of 20 financial aid counselors.

Significance of the Study

The cost of attending college has surpassed federal financial aid limits and fewer parents are paying the balance. Private lenders have targeted undergraduate students to obtain private loans to fill the financial gap. Private student loan volume has grown at an alarming rate. Many students do not have parents or other adults to help them navigate one of the largest financial investments they will ever make. Financial aid counselors, more than anyone else on campus, are in a position to responsibly advocate for students' financial interests and to discuss quality consumer information with students and families.

While diverse private loan options may be helpful to undergraduate students in meeting a wide array of financial needs, there currently are no academic standards for counseling students on private loans. Federal financial aid requirements for counseling

undergraduate students on federal student loans do not pertain to private student loans. The U. S. Department of Education has no authority or jurisdiction over private loans. This leaves the profession's ethical standards to guide the role college financial aid counselors have in counseling undergraduate students on private student loans.

Prior research specific to private student loan counseling is basically nonexistent. This study is significant to lay the groundwork and to determine what private student loan counseling is currently being provided to undergraduate students by college financial aid counselors.

CHAPTER TWO

LITERATURE REVIEW

Financial Aid Counselors

College financial aid counselors have played an important role in postsecondary education, primarily in assisting students to achieve their educational potential by packaging appropriate sources of financial aid. Financial aid is money provided by the federal government or other entities, such as a school, state government, or private lenders, to help students pay for college. In many students' and parents' eyes, the financial aid office stands between the student's admission to and enrollment at the school. Financial aid counselors, more than anyone else on campus, are in a position to advocate responsibly for students' financial interests at the institutional, state, and federal levels and to discuss quality consumer information with students and families (NASFAA, 2003, p. 1).

The National Association of Student Financial Aid Administrators has a statement of ethical principles. Within this statement, the primary goal of the financial aid professional (counselor) is to help students achieve their educational potential by providing financial resources. Counselors are to be committed to removing financial barriers for those who pursue postsecondary learning, to making every effort to assist students with financial need, and to educating students and families through quality consumer information (NASFAA, 2003, p. 1).

While the U. S. Department of Education does not regulate how a postsecondary school packages aid, it does require that the counselor of the institution inform all

students about all federal, state, local, private, and institutional student financial assistance that is available. In addition, the U. S. Department of Education requires that the participating institutions describe the procedures and forms for application, the eligibility requirements, the selection criteria, and the criteria for determining the amount of aid awarded (U. S. Department of Education, 2007, p. 9).

Using all available federal and nonfederal aid, the financial aid counselor constructs a financial aid package that comes as close as possible to meeting the student's demonstrated financial need. A financial aid package can include only federal loans, only private loans, or a combination of both federal and private loans. Because federal funds for financial aid programs are limited, the amount awarded can be less than the amount for which the student is eligible. The counselor, in an award letter, presents the financial aid package to the student. The student may then accept or decline any of the financial aid offered (U. S. Department of Education, 2007, p. 9).

When packaging financial aid, counselors prefer to package with grants; however, given the high demand for these limited resources, aid counselors have come to rely heavily on student loans. Aid counselors prefer to package federal loans, but for many, their needs still are not fully met after packaging the maximum Stafford and Perkins loan amounts that students are eligible to receive. The hard reality is that the average family needs 20% more money to go to school after they have exhausted all federal loans and aid (Burd, 2006, p. 3). Credit-worthy parents can borrow a credit-based Parent PLUS loan to help pay the education expenses of dependent undergraduate students enrolled at least half time in an eligible program at an eligible school. Some financial aid counselors

include a Parent PLUS loan in the package, but others consider discussing private loan options with students (Wegmann et al., 2003, p. 38).

A growing number of applicants decline Parent PLUS loans for varying reasons, including some who just do not qualify. As a financial aid counselor at a private college in the Southwest stated, “When parents hear that PLUS loan repayments come due in 60 days, they find it much more appealing to cosign private loans because those loans don’t go into repayment until the student leaves school or graduates” (Wegmann et al., 2003, p. 72). Parents who had not borrowed PLUS loans were more inclined to have obtained private loans. Unlike the federal PLUS loan, a private loan is not forgiven if the parent dies or becomes permanently disabled (Wegmann et al., 2003, p. 49).

In recent years students have approached financial aid counselors and requested either different or additional options to finance their postsecondary education. Students may be ineligible for federal financial aid for a variety of reasons, including not making satisfactory academic progress, taking too long to complete their education, missing the application deadline(s), or reaching their federal loan limits. In the 2002 College Board and NASFAA, approximately 50% of students accounted for their unmet need by working, but the other half turned to private loans to fill the gap (Wegmann et al., 2003, p. 39).

Private student loan volume is growing more rapidly than federal student loan volume (Private Student Loans, 2007, p. 1). Since 2001, lenders have aggressively pursued the undergraduate market and the volume soared. Lenders recognized that marketing their private loan products more aggressively to undergraduate could bring in

large profits (Burd, 2006, p. 2). If current trends continue, annual private education loan volume will surpass federal student loan volume by 2017. There are currently many private student loan providers with products. This makes it important for students to obtain enough information to compare different private student loans. Private student loans feature faster approval rates and usually allow borrowers to withdraw larger amounts of money than federal loans (McCullough, 2007, p. 1).

Federal loan regulations require students receiving a federal Stafford loan to complete entrance counseling when school begins and exit counseling after the borrower graduates or exits from school (Littlefield, 2007, p. 1). The counseling sessions help students develop a budget for managing educational expenses and understanding loan responsibility. The counseling must be in person, by audiovisual presentation, or by interactive electronic means (SallieMae College Answer, 2007, p. 1).

According to Entrance and Exit (2007, p. 2), the required entrance counseling session reviews basic facts about student loans:

- loan terms and conditions,
- rights and responsibilities of borrowers,
- use of the master promissory note (MPN),
- repayment and consolidation plans,
- deferment, forbearance, and cancellation options,
- late payment and default consequences,
- budgeted money,
- financial responsibilities while in school, and

- responsibilities in keeping lender(s) informed.

Federal regulations also require that institutions offer exit counseling to federal student loan borrowers who are leaving school or dropping below half-time enrollment. Exit counseling includes a number of important elements (Entrance and Exit, 2007, p.2):

- borrower's rights and responsibilities,
- loan repayment, and
- consequences of default (including bankruptcy).

During exit counseling, borrowers are also asked to provide updated personal information, such as employment, address, and telephone number (Entrance and Exit, 2007, p. 2). Schools must keep documentation that the borrower received the required exit counseling, either in person or by mail. If a borrower fails to attend a scheduled exit counseling session, written exit counseling materials must be mailed (SallieMae College Answer, 2007, p. 1-2).

Even when colleges and universities attempt to be proactive by providing literature to students and parents about financial responsibility and debt management, the materials can go unread or be introduced too late in the borrowing process. One aid counselor in a large Midwest public university explained, "Many undergraduates are surprised to see how much they actually owe when they have their exit interview" (Wegmann et al., 2003, p. 43).

Financial planning workshops and sessions at orientation have been helpful to some degree, but financial aid administrators remain concerned about students' overall lack of financial knowledge. In their opinion, students do not know the basics. In the