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Student loan interest crisis? New bill could eliminate rates for many borrowers

Alicia Wong
USA TODAY

Tens of millions of Americans who have student loan debt are expected to resume making payments in the fall. The interest that comes with that debt will kick in again, too.

For many borrowers, that interest has been the obstacle to paying off their loans. Advocates say the return to payments, for which the Education Department is now preparing after the Supreme Court struck down President Joe Biden's sweeping debt forgiveness plan, could be catastrophic financially.

But new legislation written by Rep. Joe Courtney, D-Conn., and Sen. Peter Welch, D-Vt., aims to get rid of that interest for current borrowers while capping it based on a sliding scale for future borrowers. The bill, unveiled and shared exclusively Thursday with USA TODAY, also would devise a means of paying for the lost interest – one that wouldn't leave taxpayers covering those costs.

Not just student loans: Interest overwhelms borrowers

Student loan payments, which have been on hold since the start of the pandemic, will be due starting in October.

It's not just payments that have been on pause. The interest that comes with them, cut to 0% for more than 3 years, also will resume starting Sept. 1. For many borrowers, that looming expense is just as bad as – if not worse – than the principal owed.

Interest rates on federal student loans are fixed based on the year borrowers take them out, but the interest is often added to the principal right away and accrues every day. While most borrowers generally don't have to start paying down their loans until six months after they graduate, interest does add up if they go into forbearance.

Interest also continues to accrue for borrowers on income-driven repayment plans even when their principal amounts are reduced. Often it's collected not just on the principal but on the administrative fees charged.

"My government is making money off of me," said Lisa Rapaszky, a grassroots organizer who recently earned her master's degree and says she has more than $30,000 in student loan debt, in an Education Department hearing recently. The hearing was meant to gather feedback from members of the public as the department works with experts to change federal law and allow for widespread forgiveness.

Rapaszky, 50, emphasized that student loan interest reform would go a long way toward helping her pay off her loans, remain in her public service research field and save for retirement. Once payments resume, she said, her estimated accrued interest will cost nearly $5 a day. “It's just too much,” she said, noting her interest rate is 5.28%. “That is not a good interest rate – and in this case, it's coming from my government.”

Federal student loan interest, which is typically fixed, is set at 5.5% for undergraduates this upcoming school year. For graduate students, it’s 7.05%.

Trust fund approach

There have been a number of attempts to address the interest on student loans. One new repayment option from the Biden administration will cut borrowers’ payments from 10% of discretionary income to 5% and forgive balances after 10 years of payments – far less than other income-based plans. When it comes to interest, borrowers on this new so-called SAVE plan won’t be charged for unpaid monthly interest, so a borrower’s loan balance can’t grow as long as they are making payments, even if their payment is cut to $0 because they earn a low wage.

Other legislation has been introduced to tackle interest, too. One bill introduced last month by Republicans in Congress would, among other prongs, cap interest for borrowers who are going through income-driven repayment. Another would forgive existing interest owed on federal student loans while setting the new rate to 0%.

But this, the bill’s sponsors say, would be the first bill to address the interest question as a whole – and to create a mechanism for covering the resulting costs. That mechanism: a trust fund that would be created with borrowers’ principal payments and then invested in various bonds.

This trust fund approach is “a very novel,” said Courtney, who co-sponsored the bill.

“The beauty of this bill is that it gets rid of the added burden of borrowing, which in really bad instances can metastasize and increase people’s debt levels to even above their initial principal balance,” Courtney said. “And it does it in a way that does not add to the deficit and does not shift the burden to taxpayers.”

This is similar to how the Railroad Retirement Trust Fund works. That trust fund invests any revenue in excess of railroad workers' benefit payments in a mix of government securities and private equities. The Congressional Research Service projected the system will remain solvent for at least the next 25 years.

“It shouldn’t be this expensive to get an education, and it shouldn’t be this hard to pay off your debt,” said Welch, who is also introducing the bill, in a statement. “We can – and should – keep pushing for debt forgiveness, but we also need to make college more affordable for future generations and avoid saddling students with additional debt from high interest rates.”

A solution for future students?

The legislation would set the interest for current borrowers to 0%, clearing that obligation entirely.

But using the trust fund, it would also eliminate or reduce interest for future borrowers. Interest would be capped at a maximum of 4%, the rates set to a sliding scale depending on the borrower’s household income. Most borrowers wouldn’t have to pay any interest.

(The idea behind the sliding scale is that students who have the means to cover some or all of the tuition don’t take advantage of the federal aid program and take out loans just to borrow at 0%.)

This “innovative solution of investing students’ principal repayments to earn a return is the first plan that addresses the cost of the student loan program,” said Bob Hildreth, president of the Hildreth Institute, in a statement. “It comes at a critical time as students must renew payments this fall without the benefit of cancellation."

The Hildreth Institute, a research and policy center focused on improving access to higher education, helped the lawmakers develop the legislation’s model.

Bipartisan appeal? No unfair burden on taxpayers

It also comes at a time when the public remains divided on the merits of broad forgiveness and of Biden’s latitude when it comes to providing it. Biden “is maxing out the executive branch authority that he has,” Courtney suggested.

The Hildreth Institute “is very sensitive to the political reality that if you don't have a pay-for, then you're basically asking other taxpayers who aren't participating in student loans or whose kids aren't participating in student loans to foot the bill for eliminating interest rates,” Courtney said.

Whether the bill will gain any traction is hard to say. Similar proposals have languished amid fierce partisan fights over full-blown cancellation.

But “I think the fundamental attraction to this bill – whether you’re a Republican or Democrat or Independent – is that the government should not be making money on the student debt program,” Courtney said. And the way the parameters are set up now, Congress is the only entity with the authority to change that.

Contact Alia Wong at (202) 507-2256 or awong@usatoday.com. Follow her on Twitter at @aliaemily.