

REINSURANCE

The second major amendment to the program would be the initiation of a new form of assistance to State loan guarantee programs. The 1965 act provided for \$17.5 million in Federal "seed money" advances to help State programs get started. These funds now have been largely used up. In a number of States, loans cannot continue to be made unless additional guarantee capacity is provided.

The 1965 act did provide a backstop arrangement under which the Commissioner of Education could directly guarantee loans whenever State guarantees are not available. Use of this authority, however, could have a most unfortunate effect upon State participation in this program. If the Federal Government does come in to guarantee loans whenever a State fails to continue its own guarantee program, there may be little incentive for the States—such as New York and Massachusetts, which have had a long history in this program—to continue their efforts and participation.

Our proposed amendment attempts to meet the need for additional guarantee capacity without encouraging some of the States to abandon their State guarantee programs. We propose that the Federal Government reinsure 80 percent of the loans guaranteed by State and private nonprofit loan guarantee agencies.

Guarantee agencies generally have been operating on a 1-to-10 ratio—\$1 of reserve funds for each \$10 of loans outstanding. By reinsuring 80 percent of the loans, we can make it possible for the guarantee agency to guarantee \$50 in loans instead of \$10. This has much the same effect as the distribution of additional seed money to supplement the reserve funds, but postpones the actual payment of the money by the Federal Government until it is needed.

This arrangement would immediately increase guarantee capacity in all participating States, but it would encourage rather than discourage the continuation of State programs, since it still would be necessary for States to provide the basic reserve funds, and the Federal reinsurance would then give the greatest benefits to States which provide the largest reserves. The reinsurance arrangement would be a striking example of creative cooperation between the States and the Federal Government. The States, with their superior knowledge of local conditions, would administer their own guarantee programs. The Federal Government, with the world's best credit rating, would use its credit to help support the State guarantees.

Now let me comment on how the reinsurance proposal would work in a specific instance.

In the case of a State in which the seed money has been exhausted, the adoption of the reinsurance proposal could have the effect of freeing up to four-fifths of the seed money and making it available to support additional loans to students. Thus, if a State now has \$100,000 of seed money backing loans totaling a million dollars, it can, at present, insure no additional loans. But with reinsurance covering four-fifths of any losses that might be incurred, the same \$100,000 of seed money could support, not just \$1 million in loans, but \$5 million in loans. Consequently, enactment of the reinsurance provision would give the State—for example, a State such as North Dakota, which