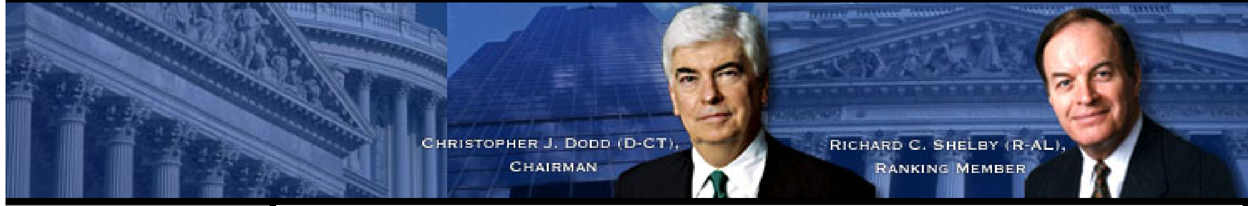


US Senator Christopher J. Dodd	**US Senator Richard Shelby**
Chairman	*Ranking Member*

Committee: US Senate Committee on Banking, Housing, and Urban Affairs
Title: Paying for College: The Role of Private Student Lending
Date: 6/6/07
Time: 10:00 AM
Place: 538 Dirksen Senate Office Building

Member Statements

- **Senator Christopher J. Dodd**
- **Senator Robert P. Casey**

Witness Testimony

Panel 1

- **Honorable Andrew Cuomo** , Attorney General, State of New York

Panel 2

- **Mr. Barry Goulding**, Senior Vice President, Sallie Mae
- **Ms. Tracy Grooms**, Senior Vice President, Bank of America
- **Mr. Peter Tarr** , General Counsel, First Marblehead Corporation
- **Mr. Sevester Bell**, Director of Student Financial Aid, Howard University
- **Ms. Jennifer Pae**, President, United States Student Association
- **Mr. Luke Swarthout**, Higher Education Associate, US-PIRG
- **Mr. Jonathan Avidan**, Consumer

Statement of Christopher J. Dodd
U.S. Senate Committee on Banking, Housing, and Urban Affairs
"Paying for College: The Role of Private Student Lending"
June, 06 2007

The Committee will please come to order. This morning, the Committee examines the role of private student lending in keeping college affordable and accessible. I want to thank Attorney General Cuomo and our other witnesses for their appearance today.

I can think of no more important topic that this Committee can address at this particular time. Our nation – and our world -- is growing more complex and interconnected by the day. Never has higher education been more crucial to the success of our people and our country. If our children are to achieve their highest aspirations, and if our nation's economic backbone is to continue to grow strong, then we must ensure that the financial doors of higher education remain open for all who have the desire and ability to walk through them.

Today, 60 percent of the new jobs being created by our economy require at least some post-secondary education. Compare that to a half-century ago, when only 15% of new jobs required some amount of college.

Yet, at a time when higher education has never been more important, in a very real sense it has never been more difficult for many families to afford. Over the past two decades or so, the cost of attaining a college degree has risen at approximately twice the rate of inflation. That is a staggering fact that has imposed a staggering burden on lower- and middle-income families in our nation. Today, the average cost of attending a public university is about $13,000 per year. The average cost of attending a private university is more than double that -- $30,000 per year, with some schools costing as much as $50,000 per year.

As the father of two young daughters, I am not making plans to retire any time soon.

During that same period of time, the federal government's commitment to student financial aid has waned in relation to the rising cost of a college diploma. Federal aid in the form of grants and federal loans has failed miserably to keep up with rising costs.

By some estimates, the national gap between the cost of tuition and available aid is approximately $120 billion – and growing. This college affordability gap leaves many would-be students with few options: to give up their dream of pursuing a higher education degree; to rely on their parents for financing their educational expenses; or to seek out alternative sources of financing their higher education – primarily through the form of private educational and "direct-to-consumer" loans.

Unlike federal student loans, private loans are not guaranteed by the federal government, and while guaranteed student loans carry a rate of no more than 6.8%, there are no limits on the interest rates and fees private lenders can charge. Some have variable rates of up to 20%.

Generally, the underwriting for private education loans is similar to that used for other forms of consumer credit. That means that student borrowers, who usually have little to no credit history, poor credit scores, or no parental co-signer or whose parents have a poor credit history, will typically pay higher rates than those with a good credit history or those with a parental co-signer with good credit history. In some regards, this model runs counter to the longstanding federal purpose of student aid – targeting low-cost financial assistance to students with the greatest needs and those from the humblest of backgrounds.

That said, there's no doubt that private loans play a critical and needed role in providing students with the ability to finance college. But while beneficial, little is known about the private student loan market. We look forward to learning more about this market at today's hearing, which will focus on an array of issues related to the growth of the private loan market, its oversight and the role private lending plays as part of the broader financial aid landscape.

I also look forward to learning more about how private lending practices, products and services impact student borrowers and their families and hearing from our witnesses about potential areas of concern within the private loan market.

Since the beginning of the year, there has been a consistent purpose to many of this Committee's hearings: specifically, how to better ensure that financial tools like sub-prime mortgage lending and credit cards can be utilized by working Americans to build, rather than diminish, wealth. Today's hearing is in keeping with that vital purpose.

The private student loan market is growing at an astronomical rate – by 1,200% percent over the past decade – and private student loans are projected to overtake federal educational loans as the largest percentage of student lending within the next decade .

We have an obligation in this Committee to ensure that this market is functioning effectively and efficiently – for lenders and borrowers alike. We must act – including legislatively if need be – to ensure that young people of this country have an opportunity to rise as high as their talents will take them.

And we must not allow young, unsophisticated borrowers and their families to be subjected to practices that deny them the ability to obtain credit on fair, transparent and reasonable terms. Otherwise, countless students will suffer serious and irreversible harm to their financial futures – and our nation's economic and social future will suffer, as well.

One of the greatest contributions made by our government to its people has been our support of higher education. Laws like the GI Bill, the National Defense Education Act, and the Higher Education Act of 1965 stand as one of the great bipartisan achievements of the past half century in terms of opening the doors of higher education to hard-working Americans and their children.

The results of this commitment have been unmistakable and remarkable. In 1955, 3 million young people attended a college or university. By 1980, that number had risen to 12 million. Today, it stands at 18 million. And our nation's economy during the past half century has not coincidentally become the strongest and most prosperous in the history of the world.

Yes, college education is expensive. But if you think education is expensive, try ignorance. Our nation can ill-afford not to support its children and their families as they work to achieve prosperity and economic security for themselves and our nation.

I am now pleased to recognize Senator Shelby for any opening statement he wishes to make.

Statement of Robert P. Casey
U.S. Senate Committee on Banking, Housing, and Urban Affairs
"Paying for College: The Role of Private Student Lending"
June, 06 2007

I would like to thank Senator Dodd and Senator Shelby for calling today's hearing on this important and timely topic. I would also like to thank the witnesses for appearing today. Attorney General Cuomo has been on the front line of exposing the problems with private student loans as well as the front line of the search for solutions.

I would also like to say that I am pleased to welcome a constituent and resident of the Commonwealth of Pennsylvania. Jonathan Avidan is a resident of Langehorne, Pennsylvania. I wish he could be here under better circumstances, but unfortunately, he is a victim of bad educational loans. I would like to thank him for coming before us today to offer his experience.

The growth in the private student loan market has been a product of two regrettable trends – the rapid increase in the cost of education, and the failure of federal student loan programs to meet the needs of students who have had to find ways to finance their education.

The fact is that federal policy and institutions of higher education have created a vacuum, and the private sector has helped to fill that void. That is a good thing, but it has had some negative consequences. Past inaction, and lack of leadership on the part of the government, however, is no excuse for inaction now, and so I am glad that we are holding this hearing to help understand the scope and boundaries of the problems we now face.

This issue involves our families, our education system, our future economy and society, and our values. We need more students going to college and getting degrees and entering the workforce highly educated and highly skilled. But increasing costs and punitive debt burdens work in the exact opposite direction.

Before the witnesses deliver their testimony, I would like to just highlight three problems:

1. The first is the breach of trust between schools and students. There is an important relationship there that some schools, though certainly not all, have been far too cavalier with.

2. The second is deceptive and in some cases predatory and abusive practices on the parts of lenders.

3. The third is the way that some of these lending practices undermine federal student aid policies, which are designed to make college affordable and accessible to all students.

This last problem is less obvious, but extremely important. As a society, we have for a long time directed the most aid to those with the most need, because hard work and ability is important and because we as a nation benefit when we allow people to use their talents to their fullest. All of America and Pennsylvania have benefited from this ideal. We cannot afford to let our investment in that ideal be undercut.

I again, would like to thank Chairman Dodd for calling this hearing, and would like the witnesses to know I am particularly interested in what actions they feel should be taken moving forward to help fix the problems we are today confronting.

STATE OF NEW YORK ATTORNEY GENERAL

ANDREW M. CUOMO

TESTIMONY

UNITED STATES SENATE
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

Washington, D.C.
June 6, 2007

I thank Chairman Dodd, Ranking Member Shelby, and the members of the Senate Committee on Banking, Housing, and Urban Affairs for inviting me to speak this morning.

I. Background

Over the last few months my office has conducted an investigation into the student loan industry. During the course of this investigation, we have uncovered several significant, deceptive, and illegal practices. Unfortunately, these practices are widespread throughout the country and throughout the many segments of the industry, including the lucrative private or alternative loan market. These practices have affected hundreds of thousands of student borrowers and their parents.

It is easy to see why the results of our investigation have struck such a chord with the public. The costs of higher education are soaring and have been for some time. Grant and scholarship funds have not kept pace with rising tuition. Accordingly, a significant and growing number of students and their parents turn to loans to cover what they otherwise could not afford. Nationwide, two-thirds of all four year college graduates have loan debt. The student loan industry has swelled to become a greater than $85 billion per year industry.

The amount of federally insured loans each student and parent may take out has, like grants and scholarships, not kept up with the increasing costs of higher education. This has pushed students and parents into less favorable private loans. Private loans are the fastest growing segment of the student loan industry and have become the most fertile ground for unscrupulous practices. In spite of the large number of students and families affected by the student loan industry, the procedures of applying for and receiving loans are enormously complex and confusing. This is especially so for private loans. Because private loan rates are not set by Congress and pricing is generally unregulated, the complex array of private loan

products is, to say the least, dizzying. Private loans are the Wild West of the student loan industry.

Faced with the broad array of choices, parents and students often seek advice from school financial aid offices. Students quite reasonably trust that the institutions will give them unbiased guidance as to how to best finance their education. In response, many institutions of higher education have created lists of recommended lenders. In some instances, these "preferred lender lists" contain dozens of lenders that meet certain minimal requirements. In other cases, educational institutions use the lists to recommend a handful of lenders, or even a single lender, as "preferred." The benefits to the lenders of being included on these lists are considerable. Lenders on preferred lender lists typically receive up to 90% of the loans borrowed by the institutions' students and parents. With this loan volume come vast profits for included lenders.

Unfortunately, we have found that lenders have often corrupted these preferred lender lists by paying schools to put them on the lists, even if they are not the best for students. The best interests of the lender and the institution, rather than the interests of the student, all too often have become paramount.

I will now take this opportunity to elaborate on a few of the troubling, deceptive and often illegal practices that we have uncovered.

II. Problems Uncovered

A. Revenue Sharing

What I believe to be the most egregious practice that we have uncovered so far is a form of kick-back scheme often referred to as "revenue sharing." Revenue sharing is an arrangement under which a lender pays an institution of higher education a percentage of the principal of each loan taken out by a borrower at the institution. I note that, so far, we have uncovered revenue

sharing only with respect to private loans. Private loans have fostered these types of agreements because Department of Education regulations preventing lenders from providing inducements to colleges have not applied to non-federally guaranteed loans. And the federal banking regulators have taken no action with respect to these arrangements.

The practice of revenue sharing creates a potential conflict of interest on the part of the institutions of higher education. When and if the institutions direct students to lenders, the direction should be based solely on the best interests of the student and parents who may take out loans from the lenders. Because of these revenue sharing arrangements, however, the institutions have a financial interest in the student or parents selecting the revenue sharing lender, regardless of whether that lender offers the best rates and service for that borrower. The advice the students and parents sought from a trusted source may not be so impartial after all.

B. Preferred Lender Lists

As I mentioned before, many schools maintain preferred lender lists and encourage students to borrow from the lenders whose names appear on the lists. Despite the significant role that these lists play in determining the lenders from which students and parents borrow, many institutions have chosen not to inform their student and parent borrowers about the criteria used to formulate the lists of recommended or preferred lenders. In some instances, they have even gone so far as to actively conceal the methods by which their recommendations derive. Worse, some institutions have failed to disclose the potential, and all too often actual, conflicts of interest on the part of their financial aid offices – the same offices that compile the preferred lender lists. These conflicts of interest may arise from the revenue sharing arrangements I just described or from other perks or consideration granted to schools and financial aid employees, some examples of which I will describe in greater detail.

C. Improper Relationships Between Lenders and School Administrators

Our investigation has uncovered potential conflicts of interest created by financial aid administrators who have held stock in a private lender, having been encouraged to purchase the stock by one of the lender's executives. In other cases, financial aid administrators have received payment for consulting with lenders. In several of these cases, the implicated lenders succeeded in getting themselves placed on the implicated administrators' schools' preferred lender lists.

Not all of the improper perks have been so egregious, but many have been exceptionally widespread. Many lenders have paid travel expenses and honoraria for financial aid officials to attend meetings and seminars in attractive locations often as part of an appointment of the institutions' financial aid officials to "advisory boards" or "committees" sponsored by the lenders.

We have also uncovered many examples of lenders paying hundreds of thousands of dollars for printing services at the request of financial aid officers. Some lenders have also sent their own staff to assist schools' financial aid staff on the schools' campuses. The lenders did not offer these services out of the goodness of their hearts. Similar to the revenue sharing arrangements, lenders granted institutions of higher education these types of benefits in an effort to encourage the institutions to steer students to the lenders.

In a related problem, lenders have agreed with institutions of higher education to staff "call centers" that answer students' telephoned or emailed questions regarding financial aid, loans, and lenders. Often the call center employees have not only failed to identify themselves as employees of a lender, but have been instructed to answer the phone in the institutions' name. The students calling or emailing their questions rightfully expected to receive disinterested

advice and information regarding lenders. These lender call center employees, however, have an interest in advocating on behalf of the lender that pays them.

D. Quid Pro Quo "Opportunity Loans"

Deeply disturbing, too, was our discovery that lenders and colleges had, in many instances, entered into quid pro quo high risk, high interest private loans that hurt students. Under these undisclosed agreements, often referred to as "opportunity loan programs," lenders agreed to make loans up to a specified aggregate amount to students with poor or no credit history, or international students, who the lender claimed would otherwise not be eligible for the lender's alternative loan program. In exchange for the lender's commitment to make such loans, however, the institution provided concessions or promises that prejudice other borrowers.

III. Solutions

A. Code of Conduct

Over the last few months, as my office exposed many of these practices to the light of day, I was pleased to see many lenders, schools, and associations, some of which had engaged in the most questionable and even illegal practices, agree to change course and set a new standard for the industry. To that end, we have entered into numerous agreements with major lenders and schools alike in which the schools and lenders agreed to adopt a new landmark Education Loan Code of Conduct, which will now govern those institutions' student loan practices going forward. The Code of Conduct offers institutions the guidelines many schools and lenders have actively sought and by which all schools and lenders should be willing to abide.

The Code of Conduct remedies the troubling and illegal practices we have uncovered. Specifically, the Code of Conduct prohibits revenue sharing and kickbacks in other forms, including printing services, for all loans, including private loans. The Code prohibits lenders

from funding gifts and trips for institutions' financial aid employees. The Code prohibits lender staffed call centers. Our Code also lays out strong but fair guidelines concerning, among other things, preferred lender lists, advisory board compensation, and loan resale.

My office will continue to pursue lenders, schools, and other players in the student loan industry that fail to put students' interests first. In cases where the law has been broken, we will continue to demand that the responsible entity agree to cease the illegal practices, reimburse wronged borrowers or pay into our education fund as appropriate, and agree to abide by the Code or Conduct. If not, we will sue. Further, we encourage all school and lenders, regardless of their culpability for past practices, to adhere to our code of conduct and adopt best practices so that students can be assured that they are being treated fairly.

B. State Legislation

But, to most effectively reform the student loan industry – and to restore most fully the broken trust between universities and lenders on the one hand and students on the other – legislation is necessary so that these types of reforms come to all lenders and schools. I respectfully submit that it is crucial that Congress act promptly to end the conflicts, perks and revenue sharing that have been costing our students dearly. I ask you to move quickly to ensure that, as another group of high schools students look toward beginning their college educations this fall, we have reform in place that will keep the students' interests paramount.

That is why I was so pleased to work alongside my state's legislative leadership to draft, introduce, and unanimously pass legislation that codified and added enforcement strength to the Code of Conduct for schools located in New York. Governor Spitzer signed the legislation last week ensuring that students attending school in New York will be protected. Our legislation

addresses, on an industry-wide basis, the problems exposed as a result of our ongoing investigation into the widespread conflicts of interest throughout the student loan industry.

C. National Action

The settlements into which we have entered in New York will affect millions of students and thousands of schools around the country. My office has also entered into settlements involving other states' attorneys general. Most notably because of the leadership of Illinois Attorney General Lisa Madigan and Missouri Attorney General Jay Nixon, we have been able to broaden the impact of our investigation by entering into settlements with multiple states simultaneously. The legislation we have enacted in New York will continue the reforms we began through our investigation. I hope that many other states will follow suit.

D. Congressional Action Needed

Yet there is much more that needs to be done, and we must move without delay. That is where this Congress should play a significant role.

Part of the reason the practices we have uncovered have been able to flourish nationwide over the past several years is because private loans have been growing at break-neck speed and regulation and oversight of these loans has been lacking. The federal banking regulators, for example, have failed to aggressively protect student lenders. Additionally, despite being aware of the problems, the Department of Education has neither sought authority to stem abuses in the private loan market nor has the Department of Education referred the matter to the banking regulators.

Whatever the reason for the federal government's recent inaction, now is the time for Congress to act to affect change in this industry; an industry that until very recently has functioned without proper oversight. Other Congressional Committees have put forth proposals

that seek to tackle this problem. I submit that because of the importance of private loans in funding higher education and the significant role private loans have played in the student loan scandal, Congress should ensure that any reform sufficiently address private loans.

IV. Conclusion

In closing, I urge Congress to enact stringent legislation to clean-up all of the student loan industry, including the burgeoning private loan market. This Congress must ensure that the trust placed in educational institutions is warranted and that we end the pernicious effects of financial gain through the misleading of students and their families. The stakes are too high for too many Americans' futures for Congress not to act. I look forward to providing any assistance the Committee may require of my office to help achieve these goals.

Prepared Statement of

Barry W. Goulding
Senior Vice President,
Sallie Mae

Wednesday, June 6, 2007
10:00 a.m.

United States Senate
Committee on Banking, Housing and Urban Affairs

538 Dirksen Senate Office Building
Washington, D.C.

Chairman Dodd, Ranking Member Shelby and Members of the Committee, on behalf of Sallie Mae's over 12,000 employees, thank you for giving us this opportunity to describe how we are helping millions of students and families plan and pay for one of the most significant investments of a lifetime -- a college education. We commend you for holding this hearing on this important issue.

As the nation's leading provider of saving, planning and financing solutions for college, we appreciate the opportunity to talk with you about student loans generally and the increasingly important role of private credit in helping make college more accessible. Over the last decade, college tuition increases have dramatically outpaced the growth in federal grants and guaranteed student loan limits. Increasingly, non-guaranteed, credit-based student loans are helping families close the gap between stagnant federal and state financial aid resources, limited family resources and the price tag for a college degree. Sallie Mae is proud to be a leader in making these credit-based loans available, which can make the difference in whether or not a student attends college.

At the same time, the growth in the private credit student loan market raises important consumer and policy issues. Consumers, schools, lenders and policy makers all share an interest in making

sure that students have access to college, complete their academic programs and successfully transition to the workplace. In an effort to do our part, Sallie Mae advises students to:

- Minimize their total borrowing by maximizing savings for college through 529 plans or other vehicles.
- Follow the "1-2-3 approach" to paying for college. After tapping personal financial resources, students should first take full advantage of "free" money (such as scholarships and grants); low-cost federal student loans, second; and, only as needed to close the gap between available funds and the cost of college - private or alternative loans, third.
- Take out only those loans they really need and do not "over borrow" beyond their needs.
- Understand how their loans work before they are obligated under their loans.
- Use programs and tools that help them manage their debt and meet their obligations after completing their studies.

This morning I want to describe how we help families pay for college, explain why students are increasingly turning to alternative forms of credit to pay for college, and let you know what we are doing to both reduce the need for private education loans and to help our customers repay their loans after they leave school.

About Sallie Mae

Congress created Sallie Mae as a Government Sponsored Enterprise ("GSE") in 1972 when the federal student loan program was still in its infancy to serve as a secondary market, provide liquidity for banks and to encourage them to participate in the federal student loan program. From

its creation, Sallie Mae was a privately-owned firm backed by private capital. Sallie Mae became a publicly traded company on the New York Stock Exchange in 1984.

As the student loan marketplace has grown and evolved over time, so has Sallie Mae. Our initial role as a loan secondary market and servicer kept us focused on banks as our primary customer. In the 1990s, we expanded that focus to deliver student loans to students and schools. Over the past decade, Sallie Mae has invested hundreds of millions of dollars in technology to make it easier for students, parents and schools to apply for, receive, track and repay their student loans. As a result of these investments a student can apply for and receive funds from a student loan in 24 hours instead of the weeks many of us may have spent waiting for student loan checks to arrive on campus when we were in college. More importantly, vast improvements in the loan delivery system have made it easier for borrowers to understand the process, helping to reduce default rates to historic lows.

In 1996, Congress enacted legislation to permit Sallie Mae to reorganize as a fully state-chartered entity, a process that concluded in December 2004 with the dissolution of the Student Loan Marketing Association, our GSE subsidiary. Sallie Mae has continued its focus on student loans, both federal and private, since the dissolution of its GSE subsidiary. In April 2007, the company announced that it entered into an agreement to be acquired by an investor group led by J.C. Flowers, Inc. and including JPMorganChase, Bank of America and Friedman, Fleischer and Lowe.

While our organizational structure and the student loan marketplace continue to evolve, our commitment to our customers – students, schools and taxpayers – remains steadfast. We are proud of our history of innovation, including creating the first student loan consolidation program and being the first company to offer savings to students for making regular, on-time payments. Going

forward, Sallie Mae will continue to innovate on behalf of our customers to make college more accessible. We will also continue our work with Congress and key stakeholders in the financial aid community to provide low-cost student loans in an open and transparent manner that places the needs and interests of students and their families at the forefront.

Today, Sallie Mae is the nation's leading private sector provider of higher education financing managing over $150 billion in guaranteed and non-guaranteed student loans for 10 million student and parent customers. In addition, we manage more than $17 billion in 529 college-savings plans, and over 7.5 million families use our Upromise program to help save for college through rewards earned on everyday purchases across the nation.

Sallie Mae makes about 11% of new federal student loans in our own name each year and holds approximately 27% of all outstanding federal student loans. Our employees work in major facilities in 14 states, including places like Arcade, New York; Indianapolis, Indiana; Mt. Laurel, New Jersey; Cincinnati, Ohio; Lynn Haven, Florida; and, Wilkes-Barre, Pennsylvania.

With 10 million borrower customers, 5,300 school clients, hundreds of lender partners and several guarantor clients, we are proud to be a vital provider of higher education financing solutions. In fact, numerous national observers have recognized Sallie Mae's record of accomplishment and excellence:

- **U.S. Department of Commerce** awarded Sallie Mae the Presidential "Ron Brown Award for Corporate Leadership."
- **Business Ethics** magazine ranked Sallie Mae among the "100 Best Corporate Citizens."
- **Business Week** magazine ranked Sallie Mae in the top 15 cash givers in their list of "Top Corporate Philanthropists."

- **Fortune** magazine named Sallie Mae one of its "Most Admired Companies."
- **Working Mother** magazine named Sallie Mae one of the "Top 100 Companies for Working Moms."
- **Washingtonian** magazine and **Indianapolis Monthly** recognized Sallie Mae as a "Great Place to Work."
- The **National Association of Female Executives** named Sallie Mae as one of the "Top 30 Companies for Executive Women."
- **GovernanceMetrics International** awarded Sallie Mae a perfect "10" score for corporate governance. Of 1,600 global companies ranked, only 17 received this rating.
- The **U.S. Department of Education** gave Sallie Mae its "Exceptional Performance" designation for meeting or exceeding government standards in administering loans under the Federal Family Education Loan Program.

In addition to investing in the nation's financial aid delivery system, we have also invested millions of dollars in helping students and families understand the financial aid process. For example, we created one of the industry's first websites to provide free, comprehensive and objective information to families about planning and paying for college. *Forbes* magazine has recognized the site, www.CollegeAnswer.com, six times as "Best of the Web" in the College Planning category. Sallie Mae also established and funded a charitable organization, The Sallie Mae Fund, to help open doors to higher education for all students, prepare families for their college investment, and bridge the financial aid gap when no one else can. Hundreds of our employees have traveled the country to lead free financial aid workshops, help families complete complicated federal financial aid paperwork and answer questions that students and families have about how to plan, save and pay for college.

Research conducted by The Sallie Mae Fund in recent years demonstrates that those who need financial aid the most – minority and first generation students from low-income families – understand it the least. We have made special efforts to educate these populations about how best to navigate the financial aid maze. For the last three years, The Sallie Mae Fund's "Paying for College" bus tour has been on the road taking information about college financial aid directly into over hundreds of communities, reaching over 100,000 families and presenting information in English and Spanish. In addition, as part of Sallie Mae's growth, we have entered into new strategic acquisitions that have, in aggregate, provided $2 billion in funding for five independent foundations dedicated to improving higher education.

How Families Pay for College

While our primary business is providing and servicing federally guaranteed student loans, as well as non-guaranteed "private loans" to help families meet any gap between available funds and higher education costs, Sallie Mae is more than just a student loan company. We understand that paying for college is a challenge for most Americans, and college is often the single biggest lifetime investment a family makes, other than the purchase of a home.

Families and young adults must not only provide for their every day expenses but must also invest in their futures by saving for a first-time home purchase, financing education for themselves and/or their children, and preparing for retirement. As a result, financial education, financial literacy and saving for college are more important than ever in meeting these competing financial demands. Today, the conversation about paying for college at Sallie Mae starts where it should with saving for college. Through the efforts of our Upromise subsidiary, that conversation can now begin as early as birth and can be as easy as automatic savings through rebates on everyday purchases. Upromise manages more than $17 billion in 529 college-savings plans in 10 states – Arkansas,

Colorado, Idaho, Iowa, Missouri, Nevada, New York, North Carolina, North Dakota and Pennsylvania - and assists more than 7.5 million members save money for college by earning rebates on regular purchases. Tax-advantaged 529 plans are clearly the best way for families to save for college and we applaud Congress for extending the tax incentives for consumers to save for college.

We also know that paying college bills once or twice a year can strain family cash flows. That is why Sallie Mae offers tuition payment plans to help families divide annual or semi-annual tuition payments into more manageable monthly payments. Last year, more than 300,000 families used our tuition payment plans to help pay over $2 billion in tuition and fees at 800 schools. That is $2 billion families did not have to borrow in student loans.

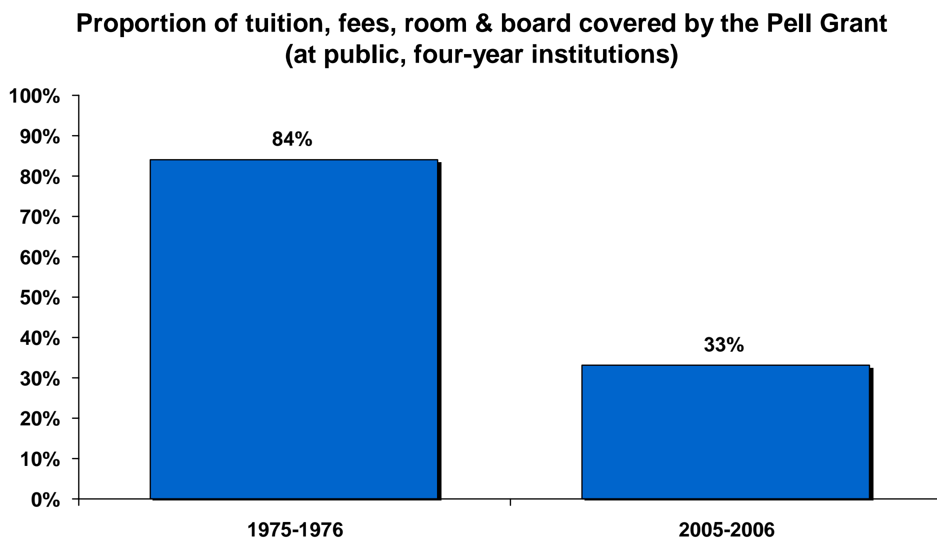
Students are also working more during the academic year. Today, 78% of students work during the academic year. And those students who work are working more hours than ever before. Students also rely on credit cards. Today, more than half of dependent undergraduates have credit cards and carry a median balance of $1,000. By graduation, credit card debt makes up nearly 10% of an average students' total indebtedness.

For many students and families, however, saving for college, managing tuition payments and working during college is not enough to pay the full price of a college degree. Through our marketing, community relations and borrower communications, Sallie Mae counsels students who need financial aid to take full advantage of "free money" first – i.e., scholarships, state and federal grants, low-cost federal student loans second, and third, private loans, as needed to close the gap between available funds and the cost of college. One example of the kind of information we make available to families to help them plan and pay for college is a free guide entitled *The Financing*

College Guide Featuring Sallie Mae's 1-2-3 Approach to Paying for College which lays out this approach to obtaining financial aid for college.

When the Higher Education Act was passed in 1965, lawmakers envisioned that grant aid would cover much of the cost of postsecondary education. For a time that was true. As illustrated in the chart below, the purchasing power of Pell Grants has fallen as the rate of growth in Pell Grant funding has been outpaced by the rise in college costs. For example, in the 1975-76 academic year the maximum federal Pell Grant covered 84 percent of tuition, fees, room and board for a student attending the average public four-year college. Last academic year, the same Pell Grant covered only 33 percent of student's costs at an average four-year public college.

Declining Purchase Power of the Pell Grant



Source: College Board, Trends in Student Aid, 2006; National Association of Student Financial Aid Administrators.

Federal Student Loans

After exhausting all of the "free money" available to them, the second step for students with unmet financial need is to apply for federal student loans. As college costs have risen and the purchasing of grant aid has declined, federal student loans have become the single largest source of federal financial aid, providing $57 billion to 7.7 million students and parents during the last academic year. Part of the reason for the growth of federal student loans is their favorable terms. Today, federal student loans are available to any eligible student, regardless of their credit history and without any collateral, income or co-signer. These loans, which are subsidized and guaranteed by the federal government, also carry the very best rates and terms available to college students. As such they are and should be the first choice for students who must borrow to help pay for college.

Interest rates and terms of federal student loans are set by Congress. Today, the nominal interest rate charged on federal student loans made to undergraduate and graduate students – which are called Stafford loans – is a fixed 6.8% regardless of the lender. Under the federal student loan program, parents of undergraduate students are also eligible to borrow the full cost of attendance (e.g., tuition, room and board, etc.) through PLUS loans. The interest rates in this program are also set under a statutory formula established by Congress. Today, the interest rate on PLUS loans made in the FFEL program is 8.5%. Last year, Congress expanded eligibility for PLUS loans to graduate and professional students.

Today, there are 3,500 lenders providing federal student loans to students and families at each of the nation's 5,300 postsecondary institutions. While interest rates on federal Stafford loans are set by Congress, competition among private-sector loan providers has reduced the cost of borrowing for college, as the U.S. Department of Education recognized in its recent Notice of Proposed Rulemaking. As part of this competition, many lenders pay federally mandated origination fees on behalf of borrowers and offer interest rate discounts and other types of discounts for graduating, on-

time payment, using automatic debit, etc. The result of competition among lenders for student loan business is that many borrowers pay less than the statutory interest rate on their federal student loans.

Nationally, 80 percent of federal student loans are made each year through the FFEL program. In fact, 4,250 schools participate in the FFEL program, compared to 750 that participate in the other major federal student loan program – the William D. Ford Federal Direct Loan program. More than 300 schools participate in both programs. Under “Direct Lending” the federal government makes federal student loans directly to students but the program is serviced by private contractors. In contrast to the lender choices available to students on campuses offering FFELP loans, students attending schools offering only Direct Loans are generally required by their schools to take out only those federal student loans offered by the Direct Loan program without the benefit of competition. As a result, students at Direct Loan schools are unable to take advantage of origination fee discounts or other interest rate reductions offered by private lenders.

Because there are literally thousands of lenders who offer federal student loans across the nation, many schools create lists of “preferred lenders” that they recommend to students at their schools. Financial aid offices frequently select their preferred lenders through a competitive Request for Proposal (RFP) process. Regardless of the lender(s) recommended by a particular school, under federal law, any student at any school that participates in the FFEL program is free to take out a federal student loan with the lender of his or her choice. The result of preferred lender lists is, therefore, that lenders are competing to offer the best terms and services to students and schools but students in the FFEL program are free to choose whichever lender they want to do business with.

When a preferred lender list is created through careful analysis by financial aid professionals it can help students and parents select a lender without relying on mass marketing materials. There is

clearly room for direct-to-consumer marketing in the student loan arena, but all stakeholders have an interest to make sure that such communications are clear and factual. We were pleased to see that Chairman Miller recently asked the Federal Trade Commission to examine unscrupulous marketing practices in the student loan arena. We share his concerns and have expressed similar concerns to federal regulators in recent years.

We also support efforts undertaken by Chairman Kennedy and others to strengthen transparency in the process of selecting lenders as part of the preferred lender process. It is important that students are fully informed that they are free to take out a federal student loan with the lender of their choice and that all parties to a student loan transaction – schools, guarantors and lenders -- act consistently to preserve the principle of borrower choice.

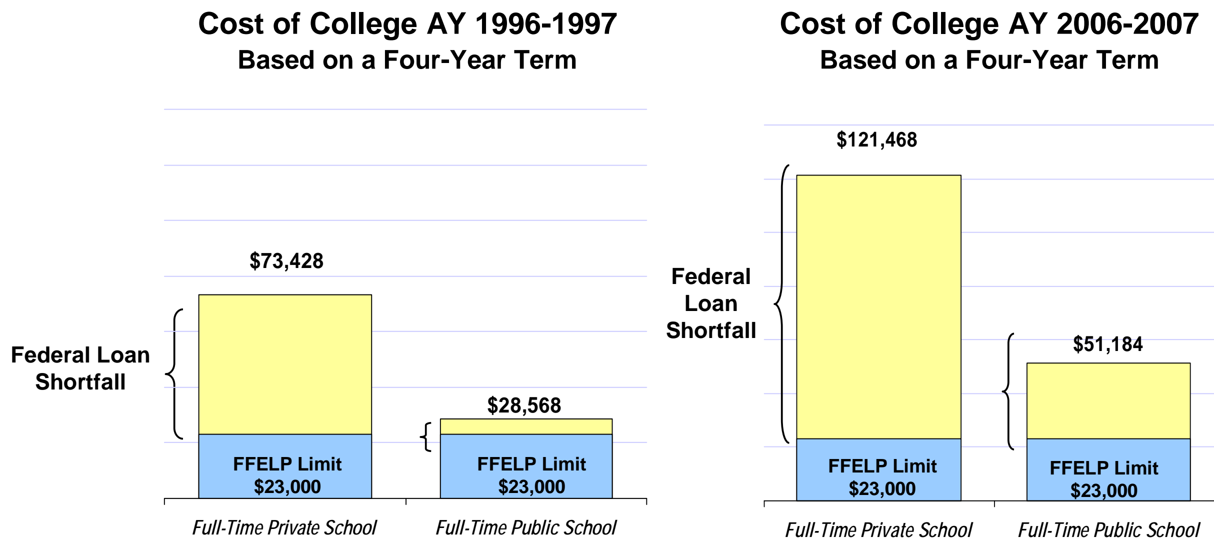
We applaud legislative proposals designed to encourage students to determine their eligibility to apply for low-cost federal student loans before seeking more costly private loans. Indeed, as described below, given the growing importance of private loans to many families, we believe that it is imperative that any student who takes out a private loan at any postsecondary institution be fully informed about the importance of exhausting grant aid and lower cost federal student loans. This disclosure is so important that all lenders and marketers who make or market private education loans should be required to disclose the availability of low-cost federal student loans, not just those who provide student loans on a preferred lender list.

Federal student loans are subject to strict statutory limits. Today, a freshman can only borrow $2,625 per academic year, sophomores are limited to $3,500 per academic year, and juniors and seniors may take out only $5,500 per academic year. Even though Congress has raised first-year loan limits to $3,500 and second year limits to $4,500 per academic year beginning July 1, 2007,

undergraduates are limited to borrowing no more than $23,000 during their entire undergraduate years.

Private Student Loans and How the Loan Process Works

In recent years, as college costs have risen, grant aid has not kept pace, and federal loan limits have stagnated, the College Board reports that the use of, and need for, private education loans has increased, although our recent experience indicates that market growth is slowing.



According to the College Board, five years ago students across the country took out $4.3 billion in private education loans in a single academic year. Last year, that number had grown to nearly $17 billion. Direct-to-consumer loans, home equity loans and other forms of unsecured consumer credit used for higher education likely make the total amount of non-guaranteed borrowing significantly

higher than the College Board estimate. To give you some perspective, as I stated earlier, federal student loans are the top source of federal financial aid. Ten years ago, private education loans represented only 5 percent of federal student loan volume. Today, private education loan volume equals about 22 percent of federal student loan volume, and that does not account for the estimated 25 percent of college students who are using credit cards to pay for some or all of college. Over the past year we have seen a significant slowing of the growth in private education loans at both undergraduate and graduate levels.

Important factors in underwriting private education loans, like any private credit product (such as an unsecured consumer loan, a credit card, automobile loan or a mortgage), are a borrower's individual credit history and whether the borrower has a co-signer with a good credit history. Other considerations include academic progress, school-specific default history and the competitive landscape. Unlike mortgages and automobile loans, private education loans are not secured by any fixed asset.

If students have obtained all of the "free money" available to them, borrowed the maximum amount of federal student loans, do not have a parent who is willing or able to take out a PLUS loan, or if they have no other sources of funds for college (e.g., working additional hours, reducing their class loads, delaying graduation, mortgaging other assets, etc.), they may pay the remaining cost of attendance using private, credit-based, education loans. In these cases, students have essentially three choices:

(1) Take out a private education loan with a co-signer. If a student's parents are unable or unwilling to take out a low-interest federal PLUS loan to cover the outstanding cost of attendance, a student can obtain a private education loan with a parent or third party as a co-signer. This approach generally offers the next best financing

alternative to federal student loans as many parents or third-parties have established credit histories that may improve the rates and terms available to a borrower.

(2) Take out a private education loan without a co-signer. Students who have exhausted federal financial aid, whose parents are unable or unwilling to take out a PLUS loan or co-sign a private education loan, or who do not have the ability to tap into home equity, may take out a private education loan using their own credit history to obtain the loan. While the terms and conditions of these loans are generally less favorable than federal student loans or co-signed private education loans, these loans may be the best option for students with limited credit history.

(3) Work more hours, deplete savings, mortgage available assets, reduce hours of attendance, change schools, delay graduation, do not attend or drop out of school. For those students who have exhausted all federal financial aid (or other sources of financial aid) and who do not wish to take out a private education loan or do not have a parent who is willing to take out a federal PLUS loan or co-sign a private education loan, they may be forced to make lifestyle changes that could affect their ability to successfully complete their education.

Many lenders provide private education loans today. The rates and terms of these loans vary, as do the credit criteria, across lenders. Some lenders only provide education loans to individuals without credit challenges. Some lenders only make loans to borrowers who meet certain income thresholds. Others provide private education loans at rates and terms designed to provide access to postsecondary education for borrowers who may have less than stellar credit.

Regulation of Private Education Loans

The market for private education loans is heavily regulated. In fact, some might argue that a private education loan is more heavily regulated than the federal student loan marketplace. For example, as consumer finance instruments, private loans are made by regulated banks, over which, as this Committee knows, there is significant oversight and monitoring. And, unlike federal student loans, the federal Truth-In-Lending Act applies to private education loans. In addition, the Equal Credit Opportunity Act, the Fair Credit Reporting Act and other federal and state lending and consumer protection laws govern private education loans.

Obtaining a Student Loan From Sallie Mae

At Sallie Mae we originate federal student loans in our own name and also provide origination services, loan servicing and loan purchase agreements to other financial institutions. During the 2005-2006 academic year, Sallie Mae originated more than $22 billion in student loans on more than 5,000 campuses. Of these, $15 billion were federal student loans and $7 billion were private education loans. Sallie Mae sponsors and/or services private education loan programs that are made available to students attending colleges and universities across the nation. As of March 31, 2007, Sallie Mae owned nearly $24 billion in private education loans. These private education loans represent approximately 16% of our total loan portfolio.

An analysis of our customers who have entered repayment demonstrates the effectiveness of the "1-2-3" approach. At the end of 2006, 85% of our customers had only federal student loans with Sallie Mae compared to 4% of customers who had only private loans with Sallie Mae. 11% of our customers had both federal and private education loans.

At Sallie Mae, we designed our private education loans to mirror federal student loans in many respects. For example, like federal student loan customers, students who take out private education loans can, and often do, borrow to cover living expenses while they are in school. Like federal student loan customers, students with private education loans can, and often do, delay making any payments until after they complete their studies. We provide borrowers, while they are in school, with quarterly statements reflecting their interest costs and encourage them to pay the interest on their student loans while in school, if possible, to reduce their future obligations. Like federal student loans, we offer students a six-month grace period after graduation before they begin making payments. Like federal student loans, we understand that students usually have little or no income while they are in school so our private education loans have no income requirements or debt-to-income ratio. And we give borrowers 15 years to pay back their private loans. The result is that lenders take 100% of the repayment risk on flexible private education loans made to people with limited credit histories on which they will not get repaid for several years. In the long-run, however, we believe that these loans are generally good investments for students and lenders because they represent an investment in human capital. Like federal student loans, this flexibility allows students to concentrate on their studies, not their debt.

While we have been successful in mirroring many of the characteristics of guaranteed student loans, we cannot mirror federal loan rates or fees. Absent the borrower subsidies and guarantee in federal student loans, lenders are forced to price private education loans using a risk-based model. A borrower's individual credit history and whether the borrower has a co-signer with a good credit history are important factors in determining the rates and terms on private education loans, like any private credit product, such as an unsecured consumer loan, a credit card, automobile loan or a mortgage. Today, the median interest rate across our entire private student loan portfolio is Prime

plus 2% and the overwhelming majority of our customers are successfully managing their private education loans.

At Sallie Mae, our commitment to our customers continues well after their loan is disbursed. Once a student completes their studies, in addition to standard repayment plans, we offer several options to help borrowers manage the repayment of their student loans. As anyone who has ever had student loans understands, it is harder to repay student loans early after graduation than it is after being in the workforce for several years. Sallie Mae offers flexible repayment plans that permit borrowers to reduce their monthly payment amount. And, borrowers who cannot make any payments at all due to extenuating circumstances can temporarily suspend making payments. We encourage our customers who are having difficulties to contact us so that we can explore ways to get them the help they need, particularly since student loan customers must understand that the decisions they make during repayment can often increase the overall cost of borrowing.

The private student loan market is growing, evolving and responding to consumer demands. For our part Sallie Mae has made a number of pro-consumer changes to our private loan program. We:

- Expanded our existing disclosures to encourage potential borrowers to max out their federal student loans before taking out private loans. Prospective borrowers are encouraged at various points in the borrowing process to seek low-cost federal loans before taking out a private loan.
- Created additional safeguards to prevent students from inadvertently borrowing more than the total cost of attendance.
- Capped private loan interest rates and fees.
- Introduced a private loan consolidation program to help borrowers lower their monthly payments. Over 75% of those who use this program lowered the interest rate on their private loans after consolidation.

- Launched an educational campaign to provide counseling tools to help borrowers understand debt before they ever take out a loan, manage debt and protect their credit score.

Student Loan Marketing Practices

Finally, Mr. Chairman, I want to comment on the recent attention on the student loan market. Business ethics is of the highest importance to Sallie Mae. Even before recent scrutiny of the student loan market, Sallie Mae adopted a "Business Courtesies and Gifts" policy to guide our employees on acceptable practices. This included guidance on state ethics laws affecting interactions with employees of state schools and this policy was distributed to all employees. In addition, each of our employees participates in annual "Code of Business Conduct" training.

We are deeply concerned about certain practices of a few student loan providers that have been described in recent media reports. As you may be aware, Sallie Mae recently entered into an agreement with the New York Attorney General to adopt a Student Loan Code of Conduct. This Code of Conduct, to which the top five FFELP lenders have also agreed, now governs our student loan marketing practices across the nation and has set a new standard for open and fair competition. In reviewing Sallie Mae's business practices, New York Attorney General Andrew Cuomo acknowledged that Sallie Mae did not participate in any of the most egregious activities that have been described in recent media reports, such as revenue sharing between lenders and schools on private loans, offering stock to financial aid administrators or providing cash payments to schools as a quid pro quo for specific loan volume. Simply put, Sallie Mae is committed to a fair and open student loan market that helps to make college more accessible to students and their families. That is why Congress created Sallie Mae 35 years ago and we pledge to honor that history as our company evolves.

Conclusion

Thank you Mr. Chairman for the opportunity to be here today to participate in this important discussion. As a leader in the industry, we are committed to working with the Congress to help more families pay for one of the most significant investments of a lifetime – a college education.

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Written Statement of Bank of America Corporation
Before the
U.S. Senate Committee on Banking, Housing and Urban Affairs
Paying for College: The Role of Private Lending

Good morning, Chairman Dodd, Ranking Member Shelby and Members of the Committee. My name is Tracy Grooms. I am Senior Vice President and Student Banking Executive for Bank of America.

Today's hearing focuses on the role of private lending in helping students and their families finance the increasing costs of higher education. We appreciate the opportunity to share our perspectives as a participant in the education loan market. I will also address sales practices within the industry and our recent decision to voluntarily adopt the Student Loan Code of Conduct established by the New York Attorney General.

Let me begin by noting that Bank of America appreciates concerns expressed by members of this Committee about rising levels of student debt. Overall debt levels are a function of rising education costs and the shortage of scholarship money and grants, not industry pricing or practices. The student loan industry has responded to consumers' demands for comprehensive education financing by developing private loan products with flexible terms that ensure loans will be repaid over time, and has done a

good job of ensuring consumers receive loans in amounts and with terms they can afford. I'll say more about this shortly.

Bank of America plays an important role in education lending. In 2006, our student lending business made it possible for over 630,000 students to attend schools, by originating approximately $4.6 billion in education loans. We originate loans that are federally backed through the Federal Family Education Loan Program of the U.S. Department of Education (called FFELP loans), and we originate private education loans, which are not federally backed.

Our student lending business is part of the bank's Global Consumer and Small Business Banking Group and is a relatively small, specialized lending segment that makes up less than one-quarter of one percent of the after-tax income of the bank.

About one-fourth of our education loans are private education loans, made in a competitive market that is the subject of the hearing today. The other three quarters of our student loans are FFELP loans.

The Bank is optimistic about growth prospects in the student lending industry, and private lending in particular. It should come as no surprise to anyone here that the number of people choosing higher education continues

to grow, especially as higher education becomes increasingly important in today's global workplace.

Unfortunately, the cost of higher education continues to grow faster than the rate of inflation. And the availability of grants and direct government or FFELP loans – which are capped at amounts far below the average cost of a college education – has not kept pace with rising education costs. Consider, for example, that the average annual cost to attend a four year public college is almost $13,000 (and $30,000 for a private college), while the maximum amount per year of a government backed loan is only $5,500.

As a result, Americans are filling this funding gap between the high cost of education and the availability of federal funding with private education loans. In short, the advent and growth of private lending is a function of market forces – increasing consumer demand for higher education and education financing.

Such trends have led members of this Committee to express concern about rising levels of student debt. As I have mentioned, debt levels are a function of rising education costs, not industry pricing or practices. We believe individual students' debt levels should be manageable, for two reasons. *First*, the bank's overall business objective is to serve customers

throughout the major financial events in their lives, including buying homes, retirement planning, and yes, saving and providing for children's education. Accordingly, we seek to ensure consumers receive loans in amounts and with terms they can afford. *Second*, industry participants are vigilant in managing credit losses resulting from student loans, as defaults impact the overall customer experience and margins. While many loans are securitized, the secondary market pays close attention to credit losses, and will pay less for loans originated by lenders with poor track records.

The private education loan market has produced affordable products with flexible terms. Today, for example, students can get unsecured private education loans that:

- defer all payments until the students are out of school and have an opportunity to obtain employment;
- may be repaid over periods as long as 25 years; and
- include fair interest rates, which today are between 8% (for credit-worthy students or co-borrowers) and 14%.

These are particularly favorable terms, when you consider the potential credit risk of the student population, most of whom have little or no credit histories, and when compared to other forms of unsecured debt.

We market our student loans through our sales force, which calls on campus financial aid offices, and through direct-to-consumer marketing. Our FFELP loans and private loans are marketed to schools and students in tandem. As part of this marketing, we make students and their parents aware of *all* available options for education financing, including grants, lower-interest government backed loans and private education loans. I have brought with me, for example, copies of the Bank of America Student Loan Guide, which helps students and their parents understand which loans are right for them, how to apply and how to pay them back. In addition, we engage in other non-school based education activities such as our recent partnership with monster® to create Making College Financial Planning Count (www.makeitcount.com). This helps educate students and their parents, via the internet, about the education financing process and available options.

In sum, the private education loan market serves an important consumer need, with Bank of America and other lenders competing to provide affordable products in appropriate amounts. As education costs continue to rise, this specialized and competitive market solution remains the best, and in many circumstances the only, alternative for consumers.

In the remaining time I have, I'd like to address briefly another aspect of the student lending business that has received much attention in recent months, namely, sales practices and their relationships with schools. At Bank of America, one of our core values is "Doing the right thing." Consistent with that value, we have several long-standing policies that prohibit associates from making improper payments of any kind to schools, guarantors or customers. First, all Bank of America associates are guided by Bank of America's Code of Ethics, which provides restrictions on gifts, entertainment and promotional activities across all of our businesses, including student lending. Since 2003, all Bank of America associates have been required to complete mandatory training and recommit to this Code of Ethics once each year.

Second, within Bank of America's student lending business, an anti-inducement policy prohibits inducements of any kind, and our Student Lending Promotional Activities Policy provides guidance on acceptable spending and promotional activities, and tells the associate who to consult for advice.

As a result:

- Bank of America has NOT provided lavish trips or gifts to financial aid officers;

- Bank of America has NOT used “advisory boards” of school representatives; and
- Bank of America has NOT given stock to financial aid officers;
- Bank of America has NOT provided staff to operate call centers on behalf of schools or provided computer hardware or software to schools.

We adopted these policies because they were in the best interests of our customers and our institution, where we guard our reputation and run our business carefully. For the same reason, we support industry reform today. We *voluntarily* chose to adopt the New York Attorney General’s Student Loan Code of Conduct as a way of leading by example, encouraging others in the industry to follow. We will continue to operate our business according to the highest business and ethical standards.

We are proud to be part of the student lending business. At a time of rising education costs and diminishing grants and federally backed financing, private education loans remain a good alternative for students and their families.

Thank you for your time. I am pleased to answer any questions you may have.

The First
Marblehead
Corporation

Statement of Peter B. Tarr
Chairman of the Board of Director and General Counsel

The First Marblehead Corporation
Opening Statement

Washington, DC
June 6, 2007

The First Marblehead Corporation is pleased to have the opportunity today to appear before the Senate Committee on Banking, Housing and Urban Affairs on the subject of private education loans. I'm here today on behalf of First Marblehead. My name is Peter Tarr and I serve as the Chairman of the Board of Directors and General Counsel for the company. We thank Chairman Dodd, Ranking Member Shelby and the Committee for inviting us here and congratulate them for bringing additional focus on these important issues.

We support recent efforts made by Congress to ensure that all Americans have access to higher education and affordable student financing. It is critical that students and families have a broad range of quality financing options to meet the rising cost of college education as well as transparent and accurate information about those choices.

First Marblehead provides outsourcing services for private, non-governmental education lending in the U.S. Founded in 1991, First Marblehead today employs more than 1000 people working primarily in the Boston area.

First Marblehead helps meet the growing demand for private education loans by providing financial institutions with an integrated suite of private loan services - from program design through application processing and customer support to the ultimate disposition of the loans through securitization transactions that we structure and administer. Over the past 16 years, First Marblehead has helped our lender clients deliver more than one million loans, in the process assisting more than 600,000 students and families in the pursuit of their educational goals.

Enrollment in higher education in the U.S. has grown dramatically over the past several decades, with approximately 18 million students currently attending college versus 12 million in 1980.[1] Over the same period, the cost of education has increased rapidly. Today, the average annual cost of attending a public university is approaching $15,000, while the average cost of private colleges exceeds $30,000.[2] At the same time, the availability of student aid from federal, state and institutional sources has grown at a much slower rate – creating a large and growing gap between the cost of attendance and traditional financial aid.

The annual funding gap between the cost of education and traditional funding sources such as federal student loans, scholarships and grants continues to widen and today we estimate that gap at traditional two and four-year public and private institutions to be $122 billion.[3] In fact, recent estimates indicate that federal and institutional aid covers only 20% of average total need at public four year universities, and 12% at private institutions. [4]

To address this huge funding gap and to meet the growing demand for long-term, supplemental financing for education, First Marblehead and other reputable companies have over the past 16 years created innovative products that provide reasonable, market-based pricing and attractive features for borrowers. In the upcoming academic year, we estimate the total private education loan market will exceed $20 billion.[5] Today, private loan providers are competing vigorously on the basis of price, product features, customer service and borrower benefits. The result is better choices for students and their families seeking financing options that work best for their circumstances.

Private education loans are funded by financial institutions and are not guaranteed against default by the federal government. Many private education loans have features similar to federally-guaranteed student loans, including no pre-payment penalties, in-school payment deferment and forbearance. Many programs also offer borrower rewards for on-time and electronic payment just like in the federal programs.

Because they are not federally guaranteed, the risk of default on private education loans is borne by the lender or loan holder. This most fundamental difference is a key limiting factor as to who might qualify for a private student loan. Private loan borrowers must typically qualify for the loan by meeting certain credit criteria. Not all applicants for private loans are approved for the loans: approximately one half of the applicants for First Marblehead-facilitated private loans are declined due to insufficient credit. In fact, few if any undergraduates can meet our strict underwriting criteria on their own so they enlist their parents or another experienced borrower to co-sign the loan. As a result, the "typical" private loan borrower in the programs we administer is an undergraduate student with a 50-year-old parental cosigner with an average FICO score in excess of 700.[6] Approximately 80% of the loans we process are co-signed. The remainder are generally to older students or non-traditional students –who have the requisite credit history.

The interest rates on First Marblehead-facilitated private loans are determined by a borrower's credit quality. Again because of the absence of a federal guarantee, rates are typically higher than those on federal student loans. For private loan products facilitated by First Marblehead, interest rates are based on the London Interbank Borrowing Rate – an internationally-recognized money rate index. Also, many private loans include an origination or guarantee fee which provides a reserve against potential loan default. While these may result in higher rates than federal student loans, these rates are in most cases better than those offered on credit cards or other unsecured debt, which are frequently utilized by students to pay some portion of education expenses.

Private education loans are offered by providers through two distinct channels. Historically, most private loans have been originated via the school financial aid office, similarly to how Federal Stafford Loans are administered. An increasing percentage of private loans are originated directly between the borrower – typically a student and an adult cosigner – and the loan provider. The growing range of product types, features and providers allows borrowers to choose private loan products and providers based upon their own personal preferences and selection criteria, which may include customer service quality, price, convenience, speed of disbursement, brand/provider preference and privacy concerns.

Postsecondary education is a large and highly impactful investment for students and families. With the cost of college continuing to rise at a rate far exceeding inflation[7], it is critical that students make sound financial decisions in determining how to pay for college. No one benefits – not the student, the school, the lender nor First Marblehead - when a borrower struggles to repay their private education loan. To foster smart borrowing, First Marblehead initiated a borrower information program in mid-2006 to encourage students and families to carefully consider the full range of financial aid options available to them, including federal student loans, prior to taking private loans. In the web pages and call scripts we develop with our lender clients, we have integrated language recommending that loan applicants carefully consider the full range of financial aid options available to them before turning to private loans. In these materials we inform prospective borrowers that private loans are typically used to supplement rather than supplant federal loans when the latter are not sufficient to cover the full cost of education, which is increasingly the case.

Industry data demonstrate that the vast majority of private education loan borrowers already know about, and avail themselves of, federal aid. A recent industry report cites statistics from the Department of Education indicating that nearly 9 out of every 10 private loan borrowers have applied for federal aid.[8] And in the case of First Marblehead loan programs, private loan borrowing is typically a family decision involving both students and parents. More than 80% of the students taking loans facilitated by First Marblehead have creditworthy cosigners.[9]

Regarding the regulation of private education loan programs, all First Marblehead-facilitated loans are originated by financial institutions that are subject to oversight and examination by one or more of the following regulatory agencies: the Federal Deposit Insurance Corporation (FDIC), the Federal Reserve Bank (FRB), the National Credit Union Administration (NCUA), the Office of the Comptroller of the Currency (OCC), and the Office of Thrift Supervision (OTS). By regulation and contract, these agencies' oversight powers extend into First Marblehead as agents for our client lenders. Additionally, both First Marblehead and our lender clients are subject to Federal Trade Commission (FTC) jurisdiction with regard to general commercial consumer protection regulations involving marketing and advertising practices, telecommunications rules and collection activities.

Private education loans are subject to the same Federal consumer lending regulations applicable to more familiar consumer-purpose loans such as installment loans and credit cards. The most significant of these regulations are:

- Truth in Lending Act (TILA, Regulation Z), which requires that creditors clearly and conspicuously disclose interest rates and borrowing costs to borrowers, using a specified disclosure format that allows comparison shopping between loan products. TILA also imposes certain advertising and billing dispute resolution requirements.
- Equal Credit Opportunity Act (ECOA, Regulation B), which prohibits discrimination on the basis of race, color, religion, national origin, sex, marital status, age, or receipt of public assistance income. ECOA establishes rules for taking and evaluating applications and sets adverse action notification requirements.
- Title V of Gramm-Leach-Bliley Act (GLBA, Regulation P), which requires institutions to notify customers about privacy policies and practices, describes how the institutions intend to share non-public personal information with third parties, and allows consumers to prevent that sharing if desired.

In closing, First Marblehead again appreciates the opportunity to participate in this discussion and thanks the committee and Chairman Dodd for the invitation to testify today. The employees of First Marblehead are deeply committed to working with our lender clients to provide attractive, high-value financial solutions for students and families pursuing their educational goals. We firmly support product innovation and the objective of making the process of financing higher education more efficient, transparent and understandable for students and families.

[1] National Center for Education Statistics (NCES) – *Projections for Education Statistics to 2014*
[2] College Board – *Trends in Student Loan Pricing, 2006*
[3] NCES - *Projections*
[4] College Board – *Trends in Student Aid, 2006,* College Board – *Trends in College Pricing, 2006*
[5] College Board - *Trends in Student Aid, 2005*
[6] The First Marblehead Corporation – *Risk Management Update, March 2007*
[7] United States Census Bureau – *Statistical Abstract of the United States: 2007,* College Board – *Trends in College Pricing, 2006*
[8] U.S. Department of Education – *National Post-Secondary Aid Survey (NPSAS), 2004*
[9] The First Marblehead Corporation – *National Collegiate Student Loan Trusts 2004-1 through 2007-2 Static Pool Data*

Howard University Testimony for the
United States Senate
Committee on Banking, Housing, and Urban Affairs

"Paying for College: The Role of Private Student Lending"

Howard University's Relationship with Private Educational Loan Lenders

As a participant in the U.S. Department of Education's (ED) William D. Ford Direct Lending Program, Howard University does not accept Federal Stafford Loans processed through private lenders. ED's Direct Lending Program has allowed Howard University to streamline the loan process for students by automatically packaging eligible students for Federal Direct Loans, including the Federal Direct PLUS Loan for parents and graduate students.

Direct Lending has eliminated the need for Howard students to use or direct students to any private lender for their federal student loans. The Direct Lending program is also convenient for both University processing and students. Howard University students appreciate dealing directly with ED regarding their loan repayment options and the assurance that their loan will not be sold to another lender or guaranty agency which sometimes proves difficult for students in repayment.

For fiscal year 2006, Howard University students and parents borrowed nearly $110 million in Federal Direct Stafford and PLUS loans *(see Table 1)*. In using the William D. Ford Direct Lending program in conjunction with ED recommended default management practices, the University has experienced a drop in its cohort default rate from a high of 11.7 to its FY2005 draft cohort default rate of 3.2.

Table 1 Total Loans Disbursed by Program	
Federal Program	**FY 2006**
Federal Loans	
--Subsidized	$34,542,681
--Unsubsidized	$48,131,093
--PLUS	$27,166,769
Total Federal Loans	**$109,840,543**
Total Private Loans	**$17,692,771**

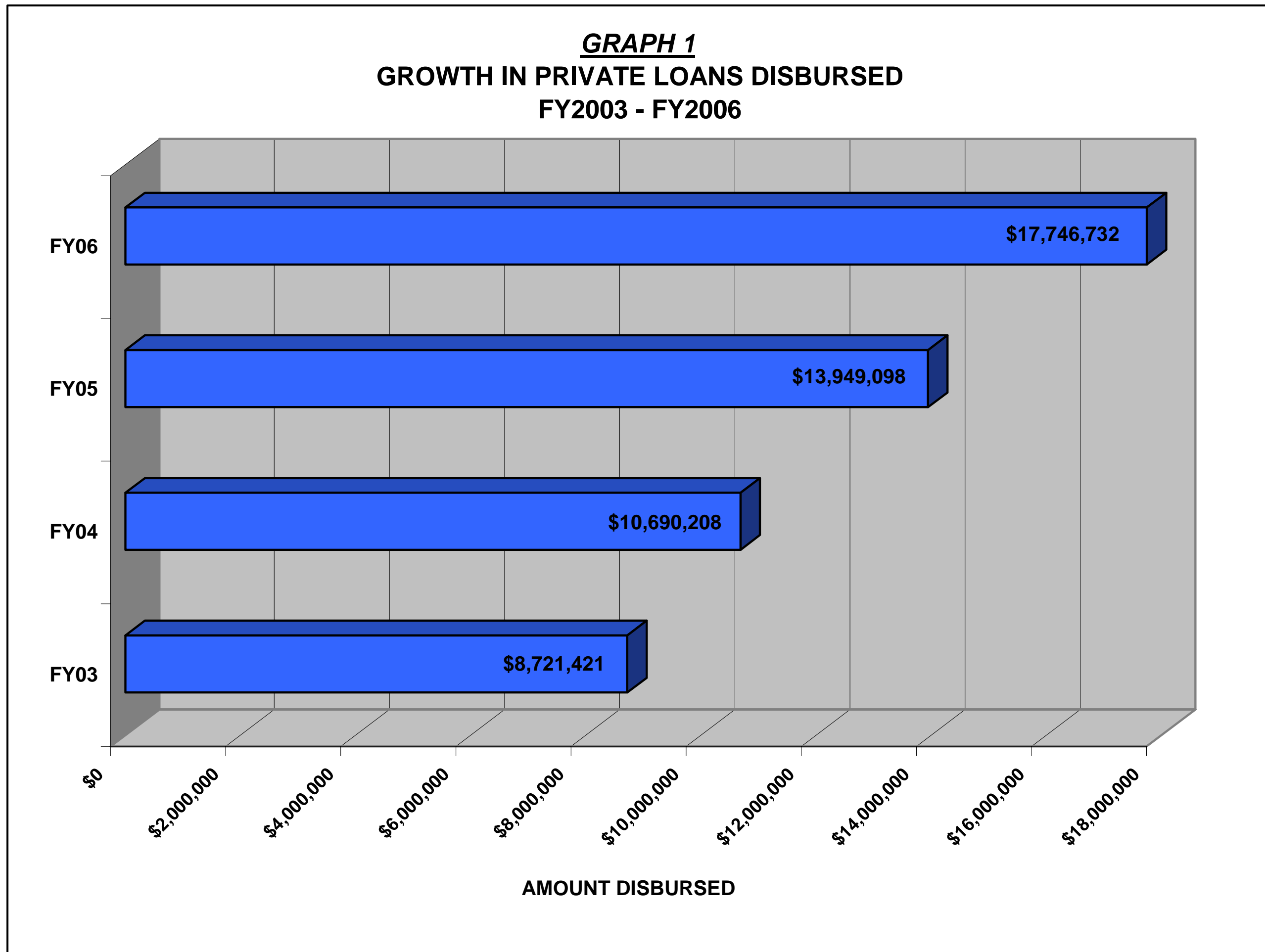
Howard University's Compliance with Federal Student Aid Regulations

Howard University remains steadfast in ensuring full compliance with federal student aid regulations. In response to New York State Attorney General, Andrew Cuomo's initial inquiries into the private lending industry and its relationships with other institutions, the University immediately clarified its existing policy on private lenders. Howard University's policy on private lenders includes the prohibition of preferred lender list and restricts financial aid officer contact with private lenders to only that which is necessary to facilitate student loan certifications. Financial aid officers are restricted from sitting on private lender boards and committees, receiving gifts from private lenders and must disclose any financial interest in private lenders or guaranty agencies. In addition, all financial aid staff members signed a statement attesting to their full compliance with Howard University's policy.

Currently, Howard University does not provide or recommend private student loans to those students eligible to receive federal student loans. However, upon inquiry, students who may not be eligible for federal student loans are instructed to conduct their own search of private student loans which should include comparing loan interest rates, repayment terms, deferment or forbearance options and loan criteria.

The Growth and Development of the Private Educational Loan Market

With record increases in the cost of higher education, the private loan industry has experienced exponential growth. For the past four consecutive years, Howard University continues to experience significant growth in the volume of alternative loans processed from a little over $8 million in FY03 to almost $18 million in FY06 *(see Graph 1)*.



Private Educational Loan Lenders' Role in Student College Accessibility

The popularity in and need for alternative loans were centered on four principal reasons. First, students who have reached their full eligibility for federal student loans must borrow through an alternative lender to secure funding each year. Secondly, students who have lost their federal aid eligibility because of Satisfactory Academic Progress (SAP) may borrow funds through select alternative lenders who do not consider SAP as a criterion for determining eligibility. The third reason relates to students enrolled in select graduate and professional programs (i.e., medicine, dentistry, pharmacy) need additional funds to offset their direct and indirect expenses, as their cost-of-attendance exceeds the maximum annual loan limits offered through the federal loan programs. Lastly, doctoral candidates in the final stages of their dissertation seek alternative loans because many do not meet the half-time requirement for federal funding.

The Office of Financial Aid continues to encourage students to first utilize and exhaust all federal loan sources before seeking alternative loans. However, it does not deter these students from taking these loans as it is a viable—if not only—resource for them to fund their education.

Student Borrowers Impacted by Private Educational Loan Lender Practices

Students from various socio-economic backgrounds chose lenders for several reasons, including the ones mentioned earlier. However, we do find that many of the students most affected by federal regulations are those from economically disadvantaged backgrounds and left with private lenders, who charge higher interest rates, as a last, and sometimes only option.

Redlining or predatory lending is probably not an appropriate description of private student lender actions. There has been no major study that suggests private lenders specifically target economically disadvantaged (or minority) students.

Private Educational Loan Lenders' Access to Student Data at Howard University

Howard University remains vigilant in protecting student data. Student data is not provided to any private lender except where required by law for repayment information. Most private lenders had about the same access to student data that a university would by using the National Student Loan Data System (NSLDS). Since the investigations into the private lending industry began, the U.S. Department of Education has restricted much of this access from private lenders and enhanced its security measures.

Implications of Private Educational Lending

For many college students who have exhausted federal loan eligibility, private educational lending is their only option. The accessibility of these loans means that these students are afforded, even if at a higher cost, the ability to fund their education and graduate. Impacted private educational loan borrowers face slightly higher interest rates, which may lead to higher payments and/or longer repayment periods.

United States Student Association

Testimony of Jennifer Pae
President, United States Student Association

U.S. Senate Committee on Banking, Housing, and Urban Affairs
"Paying for College: The Role of Private Student Lending"
June 6, 2007

Good morning, my name is Jennifer Pae and I currently serve as the president of the United States Student Association (USSA). Since 1947, USSA has served as the country's oldest and largest national student association representing millions of students across the country in the Capitol, the White House, and the Department of Education.

Currently, private or "alternative" student loans are the fastest growing and most profitable part of the student loan industry. Ten years ago, only five percent of total education loan volume was in private loans. Today they represent an estimated 20 percent of what all-undergraduate, graduate, and professional students and their families borrow to pay for school. In 2005-06, lenders issued $17.3 billion in private student loans. With the rising cost of tuition and fees and the lack of sufficient federal and state grant aid for low to middle income students and families, the private loan industry has grown exponentially off the backs of those who are the most vulnerable.

Private student loans have significantly higher interest rates, fewer borrower benefits, and often saddle students with larger debt levels than federal student loans. For example, my sister Jessica Pae went to a junior college and worked to save money before attending the University of California, Berkeley while I attended the University of California, San Diego right after high school. We now have an identical debt level of over $30,000. As a result of insufficient financial aid availability, she was forced to rely on higher cost private student loans. Nearly two thirds of the 15 million college students (over 66 percent) graduate into debt that averages $19,300 with both federal

and private loans. Unfortunately, this number is only expected to increase without Congress taking action to protect student borrowers from unmanageable levels of debt.

Students are inundated with solicitations from lenders through direct mail, the internet, and savvy advertising campaigns promising to guarantee up to $50,000 in just seconds. From letters that are made to look like official documents from the federal government or the Department of Education to co-branded loans with colleges and universities, most borrowers cannot distinguish the difference between loans that are helpful and those that are harmful. To make matters worse, lenders are taking advantage of their relationships with FFELP schools to market additional loan products such as high interest credit cards to vulnerable students.

Not only are students faced with skyrocketing tuition and fees, but they are graduating with high levels of unmanageable debt that forces them to put off starting a family, buying a home, pursuing careers in public service and even furthering their education. Paul Perry, a recent graduate of American University not only received a degree in Political Science and International Studies, but he also received a bill for over $75,000--$45, 000 of which results from private loans. Paul will be giving back to a community in need through Teach for America this fall and unfortunately, like millions of other borrowers, has no idea how he will repay such massive debt. Mike Filippelli, a junior at the University of Oregon, will be graduating next spring with over $30,000 in federal and private student loans. Mike is afraid that he will have to choose between his passion of advocacy and organizing and a higher paycheck. These stories are not atypical. This issue affects students and families regardless of economic backgrounds, from a low-income working class family who is able to receive federal grant aid, to middle income families who do not qualify for federal grant aid; many are forced to rely on private loans to fill the gap between available aid and the cost of attending college. Many of the families carrying private loan debt have also fell victim to the unclear and misleading information about private loans which further threatens their access to college.

For all of these families, especially first generation college students, a college degree is the best shot at future economic security. Yet, college is quickly becoming out of reach for millions of students. This alarming phenomenon is impacting the lives of low and moderate-income students who are having a harder time obtaining decent paying jobs. Even those who are able to attend college confront the spiraling cost of a college education as a major barrier to higher education. Instead of America stepping up to the challenge to vie in a highly competitive global economy, we are retreating by failing to invest in access to higher education and providing adequate protections from the private student loan industry. Every qualified student should be able to access post-secondary education, regardless of their economic-status and should not have the burden of high levels of unmanageable debt. A college education traditionally helps provide lower income students mobility to the higher rungs of the economic ladder. Within the last twenty years, we have made it even harder for Americans who would most benefit from a college degree to actually acquire one. With student loan debt spiraling out of control and the compromised integrity of both the federal student loan system and the private student loan industry, the need for Congressional action is more apparent than ever before.

Last fall, we filed a complaint with the Federal Trade Commission (FTC) against "Loan to Learn," a division of EduCap, Inc. based on their distribution of misleading information relating to federal student loans. Materials provided by Loan to Learn to potential customers made numerous false and deceptive claims, designed to discourage customers from applying for federal aid and to make the company's loans appear to be a preferable alternative (See attachment).

This case highlights an alarming industry practice of tricking borrowers into higher cost private loans before exhausting their safer and lower cost federal student aid options. This practice harms borrowers because they are forced into more expensive loans that carry very few borrower

protections. With student debt on the rise, these costly loans, can threaten a borrower's ability to manageably repay their loans.

Additionally, under current law, borrowers who have fallen victim to these deceptive practices have no real legal recourse because it is extremely difficult for a borrower to file a claim against a private lender. Policymakers need to regulate the industry to hold lenders accountable for deceptive marketing and lending practices.

In the best interest of our nation and our economy, these issues must be addressed now to protect vulnerable student borrowers. As an immediate concern related to private loans, the focus should be to reduce the need to rely on private loans for financing college, ensure that private loan borrowing that does occur is affordable, and mandate that clear and accurate information is presented to student borrowers to allow them to make responsible educational financing decisions. We also urge Congress to adopt legislative solutions proposed by The Project on Student Debt. These solutions include:

- Treat private student loans like other consumer debt in bankruptcy
- Clearly label private student loans as different from federal loans
- Make it easier to compare private student loans
- Protect borrowers who are harmed by conflicts of interest or fraud
- Require private lenders to disclose in plain English the rates, terms, and conditions of private loans when the student or parent receives approval

The 2005 bankruptcy reform legislation made private student loans non-dischargeable in bankruptcy unless the borrower can meet the very restrictive "undue hardship" test. This change

effectively eliminated the safety net for vulnerable borrowers buried in private student loan debt. Private loans are generally the most expensive loans and there is no effective government regulation over the terms and cost of these loans. There are also no government-imposed loan limits. Removing the bankruptcy option allows private lenders to exploit students and then deny them relief if they cannot pay. It is critical that Congress move to expand bankruptcy protections relating to private student loans.

Another concern is the lack of clear and consistent distinctions between different types of loans. This means borrowers do not always realize that they are taking out private student loans or how different the terms of these loans are from federal loans. Many students are heavily relying on private loans without first exhausting their federal loan options, despite the lower risks and costs of federal loans.

There is also an abundance of confusion when schools or lenders package federal and private loans together or include private loans branded with the college's name. This leads students and parents to falsely assume the whole package of loans they are offered provide similar terms and protections during repayment, when in effect the terms and benefits may be very different. Borrowers need more and better information about the loans they are being offered, in order for them to be able to weigh their options before they are asked to commit to private loans.

Furthermore, it is very difficult for most students and families to compare the actual terms and conditions of private student loans. Interest rates and other terms are based on the individual borrower's credit rating and other factors that each lender may weigh differently. Many lenders do not provide complete information about what a private loan will really cost until the borrower signs on the dotted line. Lenders can describe their interest rates, fees, repayment plans, and discounts in very different ways that make it hard to compare loans. Many advertise interest rates that are the lowest possible rate rather than the potential range, which could be wider than 10 percentage points.

Providing a uniform, easy to understand way to compare the real cost of a private loan across different lenders is critical to ensure that families have the knowledge they need to make informed borrowing decisions.

There should also be protections in place for borrowers who are steered into unnecessarily costly private loans or to lenders that engage in fraud or false advertising because the institution will benefit in some way. When lenders and schools have unethical relationships, students end up with private loans they cannot afford with unmanageable debt that will be nearly impossible to repay. As I learned serving on the negotiated rulemaking student loan committee, under current law, remedies are extremely limited and difficult for individual borrowers to use. It is imperative for the integrity of the student loan system and for the accountability of lenders and institutions, that borrower protections are regulated and enforced.

Finally, most private loans have variable interest rates with no caps which make it difficult to understand the true cost of the loan that a borrower may agree to. In addition, private loans above $25,000 are exempt from the Truth-in-Lending Act (TILA) disclosures of rates and terms, so students and parents may not exactly know the rates and conditions of the loan until it's too late. These disclosures are crucial in educating the borrower on their private loan package and if it is optional, families may not be getting all the facts. By requiring lenders to provide information about loans in plain English to borrowers, students and families may be able to protect themselves from unmanageable debt.

In conclusion, we urge Congress to pass legislation that regulates the growing private loan industry in order to protect the rights of current and future student borrowers. Currently, the doors of higher education is closing for millions of Americans under the weight of high cost private student loans due to inadequate federal financial aid. Financial aid packages used to be predominantly grants, but that has changed in just the last twenty years. This is greatly

impacting the lives of low and moderate income students and families who are having a harder time obtaining decent paying jobs and economic security. Economic insecurity is replacing economic opportunity for hardworking college graduates who are confronting spiraling debt. By enacting reforms in the private student loan industry, we are taking a step towards opening these doors of opportunity. Thank you for allowing me to testify before you today and we look forward to working with you to ensure that every qualified individual has a right to an affordable and accessible education.

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Testimony of

Luke Swarthout, Higher Education Advocate
United States Public Interest Research Group (U.S. PIRG)

Senate Committee on Banking,
Housing and Urban Affairs
June 6th, 2007

U.S. PIRG is the federation of state Public Interest Research Groups-- non-partisan, non-profit public interest advocacy organizations based in 30 states. We work with students on more than 100 college campuses across the country. For more than a decade, our Higher Education Project has represented hundreds of thousands of college student members at the federal level by working to increase access to an affordable college education. On behalf of our members I want to thank you for convening this hearing and offering us the opportunity to testify about the growing issue of private student loans.

The issue of providing credit to young people seeking a college education has a long Congressional history. Since the 1950's Congress has identified student borrowers as deserving federal financial support and assistance. Young people, who generally have little or no credit history and no equity, receive unfavorable treatment in the traditional credit market. The subsidized loan programs were created to provide capital to students regardless of their income and credit.

Congress has historically treated student loans differently than other types of debt because their purpose is socially valuable. Students who take out loans are investing not only in their own future, but also in our country's economic, political and social health. Today's hearing, to discuss ways to protect students from predatory private loan terms and interest rates, is consistent with Congress's five-decade interest in helping students borrow for college.

For much of the last 50 years relatively low tuition and federal grant aid meant that federal student loans provided sufficient loan capital to help students finance their

education. During this time period, mainly graduate students, pursuing professional degrees, utilized private student loans set at market rates without a federal guarantee. However, in the last decade, and particularly in the last five years, undergraduate students have increasingly utilized unsubsidized private loans to pay for college. The reason is that over the past decade as states have cut funding for public higher education and more of the cost of college has been pushed onto students, undergraduate debt levels have significantly increased. The average college graduate leaves school with approximately $19,000 in debt, but averages only tell part of the story. 7% of students now graduate with an excess off $40,000 in debt, approximately 80,000 a year. That represented a 10-fold increase between 1993 and 2004.[i] Federal loan limits cap undergraduate borrowing by dependent students at $23,000. For some students, this is not enough to cover their full college costs, so they turn to private loans for additional financing.

Private loans are utilized by a subset of undergraduates. About 5% of undergraduate students took out a private loan during the 2003 school year. At non-profit private institutions the percentage was twice as high, about 11.5%.[ii] However, because private loans are on average significantly larger than federal loans, private student debt represents about 20% of overall loan volume borrowed in 2006.[iii] Private loan borrowing has increased at about 27% annually over the past five years, a fact that has caused the issue to gain significant media attention.

Interest rates on private education loans vary based on the student's (or parent's) credit and equity. Students with little or no equity typically rely on a cosigner, usually their parent or guardian. Although information about how particular lenders calculate interest rates is proprietary, loans range from the prime rate to as high as prime plus 12%

in some cases. At current market rates those terms would result in loans at between 8 and 20% interest. Terms on private loans vary widely and do not have to include even the minimally protective repayment options that are required for federal student loans. For example, only some lenders offer deferment options on private loans, which allow student to postpone payments for a time, while interest continues to accrue and compound. In general, private student loans are a costly option for all borrowers and especially costly for low-income students, the very population our federal aid programs are designed to help.

There are a number of reasons to be concerned by the growth of private student borrowing and several critical policy reforms that this Congress should enact to safeguard borrowers. The first problem is that private loans, which can carry such high interest rates, greatly increase the debt burden that many students already struggle with. Take the hypothetical situation of a student who borrows $40,000, half from the Stafford loan program at the fixed interest rate of 6.8%, and half through a private loan with an average interest rate of 12% over the life of the loan. If the student repaid both loans over 10 years, his or her annual loan payments would be $6,000. The interest cost alone in that 10 years would be $21,000, two-thirds of which would be on their private loan. For a student earning $30,000 straight out of college, trying to cover even basic costs like housing, food and transportation this would be an unmanageable loan burden. A college degree means on average greater wealth for the graduate over their career, but not all borrowers will experience that wealth right out of school. Moreover, some students will choose paths that are less profitable, such as teaching or social work, and be faced with an untenable financial situation.

Private student loans work exactly counter to how Congress designed our federal student aid system. The grant and loan programs were created to help, in particular, low-income students who were trying to use higher education to gain access to the middle class. First generation students who were paying their own way through college are the inspiration for our Pell Grant and Stafford Loan programs. Over the past 20 years we have done these students a disservice by shifting federal aid from a majority grant system to a majority loan system. A system with so much unmet need that low- and moderate-income are turning to private loans, where those with the least resources are given the highest interest rates, is a particularly cruel abandonment of Congress's original higher education principles.

The recent sub-prime home mortgage scandal provides another warning about our reliance on private loans. The student lending industry has increasingly marketed private loans to students at sub-prime terms. High interest rate, high-risk loans have enabled banks to expand this already profitable business by lending to less credit-worthy borrowers. As we have seen in the mortgage market, many of these borrowers were unable to repay the loans, devastating thousands of families and sending shock through our economy. Because the growth in private student loans has been so rapid we have yet to see whether the industry suffers the same problems as the sub-prime mortgage market. However, should private student loans suffer the same sort of failure as mortgages, as students graduate or drop out and find themselves unable to pay, we will do serious damage to the lives of many students but also the economic and social fabric of our country that depends on college graduates for its strength.

The final problem in the private student loan industry, and one that this Committee has clear jurisdiction over, is the lack of clear consumer information. Recent studies have found that of private loan borrowers who were eligible for Stafford loans, nearly 20% of dependent students and nearly half of independent students failed to take the maximum Stafford award.[iv] That means a significant number of borrowers took private loans when they had additional capacity to borrow more affordable federal loans. This reporting was consistent with a problem identified in a 2003 U.S. PIRG report looking at college graduates from 2000.[v] At best this trend suggests confusion on the part of borrowers; at worst, it is a symptom of misinformation and manipulation by lenders advertising their private loan products.

Those students who fully understand their options and still decide to take a private loan have no means to compare loan terms between offers. Lenders do not disclose how they calculate private loan interest rates, so that consumers frequently have little more than advertising copy and an "as low as" offer to base their decision on. Adding a further layer of complexity is that there is no standard APR in student loans, leaving even the most educated consumers to try and piece together the impact of various benefits and incentives offered by different lenders.

Lenders further confuse consumers by deliberately masking their products through practices such as "co-branding." In such a situation the school agrees to lend the institution's name, colors and brand to the bank's loan product. Students, having survived the FAFSA process are thus expected to discern that a "State University Loan" is actually a risky private loan wrapped in the colors of their future college. The financial aid process should be transparent and clear, designed to help students access a college

education. By contrast the growing private loan market places pitfalls in their path. We would encourage Congress to help fix this system with the following recommendations:

Recommendations

Over the past several years the private loan system has expanded beyond the scope of current regulation. What is clear in the wake of recent student loan scandals, the sub-prime mortgage crisis, and high levels of public concern about college affordability is that Congress must act to help students.

Provide students with clear information on the cost of private loans: Mandate that all private loans have an APR, provided to students before they sign their promissory note; also a cooling-off period, comparable to federal student loans, where they can return their loan at no cost.

Distinguish between private student loans and federal student loans: Mandate that schools distinguish clearly between federal student loans and private student loans in financial aid offers; ban "co-branding" of loans where banks use the logo and name of the school to make their financial product seem more appealing.

Treat student borrowers more fairly in bankruptcy: Student loans, both private and federal, are currently treated more harshly than almost all other forms of debt in bankruptcy. People who borrow to pay for college, and are subject to the high costs and

harsh terms of private student loans, deserve fair treatment, especially given the societal value of higher education.

Provide students with anti-fraud protection: Extend the FTC holder rule to apply to all schools and types of loans to ensure that schools and lenders are accountable for the financial partnerships they enter into, and that students who get ripped off have some recourse.

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[i] Project on Student Debt, *High Hopes, Big Debt*. http://projectonstudentdebt.org/files/pub/High_Hopes_Big_Debts.pdf, accessed on June 4th, 2007.

[ii] Project on Student Debt, *Quick Facts About Student Debt*. http://projectonstudentdebt.org/files/File/Debt_Facts_and_Sources_5_4_07.pdf, accessed on June 4th, 2007.

[iii] College Board, *Trends in Student Aid 2006*, http://www.collegeboard.com/prod_downloads/press/cost06/trends_aid_06.pdf

[iv] Institute for Higher Education Policy, *The Future of Private Loans: Who is Borrowing and Why?* December, 2006. http://www.ihep.org/Pubs/PDF/FutureofPrivateLoans.pdf accessed on June 4th, 2007.

[v] Kate Rube, *Private Loans: Who's Borrowing and Why?*, State PIRGs Higher Education Project, 2003.

Statement of Jonathan Avidan

Submitted to the
U.S. Senate Committee on Banking, Housing, and Urban Affairs

"Paying for College: The Role of Student Lending"

June 6, 2007
10:00 am

Chairman Dodd, Ranking Member Shelby, my own Senator from Pennsylvania, Senator Casey, Members of the Committee, thank you for the opportunity to appear here today to discuss private student loan lenders.

My name is Jonathan Avidan, I am 25 years old, recently married and living in Langhorne, Pennsylvania. I attended Boston University and graduated in May 2004 with a Bachelors Degree in Business Administration. I work for Calle Financial Network, an investment advisory business, as its Director of Operations.

My parents, like the majority of middle class Americans, struggled with the enormous challenge of spiraling college costs during my first two years at Boston University. Prior to my junior year, they told me they could not afford to pay my tuition anymore. I was faced with a grim choice - go home and enroll in my local community college, or stay at Boston University. I wish I knew at the time that the choice to stay would be the most expensive decision of my life.

I was able to borrow $18,000 of federal loans at a fixed 3.0%, but this only covered a fraction of school costs. I would be forced to find the vast majority of funds through private loans – over $60,000 for the remaining two years. I have been making payments every month for the past two years, but the balance has managed to increase to $69,000.

I was told up front that the original 6.36% variable interest rate was capped at 10.0% and that it was tied to the prime rate. How many 20 year olds know what that

really means? The truth was… the variable rate was not capped. In fact, the rate was the current LIBOR rate plus a margin of 4.85%. The 4.85% was derived, at the time, from my parent's credit score, and our combined credit-worthiness. I cannot believe that the original terms of the promissory notes could not be reevaluated after five years. Then, I was 20 years old and I had no credit history or income. Now, I am 25, with a flawless credit history and a credit score over 720 points. I deserve a better margin now than I did five years ago. Currently the rate is 9.92%.

Right now, despite generous and timely raises and my wife's income, we are hard pressed to keep up with the combination of rate increases and graduated payments. My private student loan payments, $250 when I first graduated, have gone up over 200% in the last 24 months. Currently, I am paying $600 a month. By April 2009, my payment will be approximately $1000/month. I won't begin to reduce the principal for another two years and my expected payoff date is November 2024. When it's all over and I paid off my debt to these lenders, I will have paid back close to triple the amount that I borrowed.

As a new borrower, I purchased a used car for $18,000 at 10.1% interest for six years – I find it rather remarkable that the rates on my private loans would come so close to the percentage rate on my used car. Surely, I am a better risk than a four year old sedan.

Ultimately, my life is completely affected by my private student loans. Instead of renting a one-bedroom apartment, my wife and I could be taking a mortgage on a

house. Instead of decades of interest, I could be contributing to an IRA or putting money away in a 529 Plan for my children. Instead of being forced to work right out of school, so I could afford to pay my private loans, I could have pursued a graduate degree at Wharton, a life-long dream of mine.

Our country is supposed to be a country of opportunity for anyone that has a dream. In the world we live in today, receiving an undergraduate degree is increasingly a prerequisite for success. By allowing these companies to voraciously apply wide margins to the money they lend, we risk crippling a generation with massive debt. These companies have taken advantage of an unregulated market and young Americans who want to better themselves through higher education.

Young men and women graduating from colleges around the nation are supposed to strengthen the economy once they enter the work force. But how are we supposed to help the economy when we are struggling to help ourselves? I know I am only one voice and one story, but I am sure all of you know that it is young people like myself that are the future of this country and it is only getting worse. Thank you.

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