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Before the

Senate Committee on Banking, Housing, and Urban Affairs

Subcommittee on Financial Institutions and Consumer Protection

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Chairman Brown, Ranking Member Corker, and members of the subcommittee, thank you for holding this hearing today on an issue that touches so many American students, families, and our economy.

A few days ago marked the one-year anniversary of the opening of the Consumer Financial Protection Bureau. In this year, the CFPB has taken important steps to improve the consumer financial marketplace. The mortgage market, in particular, was especially bruised and battered during the financial crisis. We hope that the CFPB's measures to increase transparency and improve oversight will help restore confidence and heal this multi-trillion dollar market with broad impact for consumers and the economy.

But we have also placed a great deal of attention on a growing market deeply connected to the American Dream – the student loan market.

To prosper in today's global economy, our workforce needs skills to innovate in a highly competitive environment. For millions of Americans, student loans have opened doors to a college degree— offering new opportunities to create a better life. But the rapid growth of student debt raises concerns that warrant significant attention of policy makers and regulators.

With outstanding student loan debt reaching the \$1 trillion mark late last year,<sup>1</sup> our economy has not just crossed a psychological threshold. Student loans are now the largest form of unsecured household debt, and the CFPB will play an active role in contributing to a properly functioning student loan marketplace.

**College is Still a Good Investment, But Not without Risk**

College is still a good investment, and higher education remains the surest path to a good career and job security. The unemployment rate for workers with college degrees is 4.1 percent, compared to 8.4 percent for those with just a high school diploma.<sup>2</sup> For younger workers, the

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<sup>1</sup> Consumer Financial Protection Bureau and U.S. Department of Education: Report on Private Student Loans (2012)

<sup>2</sup> Bureau of Labor Statistics: Current Population Survey, Household Data, Table A-4, Employment status of the civilian population 25 years and over by educational attainment (June 2012)

unemployment rate for those with college degrees is 8.9 percent compared to over 13 percent for those with just a high school diploma.<sup>3</sup>

But there is another side to this story. Much attention has been paid to the growing “college wage premium”—the difference between wages for those with a college degree versus those without.

Over the past decade, wages for young college graduates have actually declined by 5.4 percent when adjusting for inflation.<sup>4</sup> This growing “premium” is largely explained by declining wages for young people without a degree. Between 1990 and 2010, wages for workers with only a high school diploma declined by 12 percent, when adjusted for inflation.<sup>5</sup> Put another way, the growing gap is not due to a college degree becoming more valuable – it’s that the wages of non-degree holders are falling.<sup>6</sup>

But the cost of attendance at our nation’s colleges and universities has not been falling. In the past decade, the cost of attendance at public schools increased 42 percent, and prices at private not-for-profit schools increased 31 percent, when adjusting for inflation.<sup>7</sup> Tough economic times have led state governments to slash higher education budgets, exacerbating this trend. The cost of tuition and fees has risen more than tenfold since 1979, vastly outpacing inflation, wage growth and healthcare costs.<sup>8</sup>

Growing costs, declining real wages, and job market uncertainty have led to more debt and more risk. The consequences of this increased risk are real, as evidenced by troubling employment outcomes and student loan defaults, which are disproportionately felt in the for-profit college sector. While perhaps fewer in number than the struggles of American homeowners, the stories of distressed young college graduates reveal the impact of the financial crisis and the significant work that lies ahead.

### **Private Student Loans Carry More Risk**

While seemingly quite different, dysfunction in the student loan market bears some remarkable similarities to the mortgage market in the years leading up to the financial crisis. High-credit-

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<sup>3</sup> Bureau of Labor Statistics: Current Population Survey, Household Data, Table A-16, Employment status of the civilian non-institutional population 16 to 24 years of age by school enrollment, age, sex, race, Hispanic or Latino ethnicity, and educational attainment (June 2012)

<sup>4</sup> Economic Policy Institute: The Class of 2012: Labor market for young graduates remains grim (2012)

<sup>5</sup> National Center of Education Statistics: Digest of Education Statistics, Table 395, Median annual earnings of year-round, full-time workers 25 years old and over, by highest level of educational attainment and sex: 1990 through 2010 (2011)

<sup>6</sup> National Center of Education Statistics: Digest of Education Statistics, Table 395, Median annual earnings of year-round, full-time workers 25 years old and over, by highest level of educational attainment and sex: 1990 through 2010 (2011)

<sup>7</sup> National Center of Education Statistics: Digest of Education Statistics, Chapter 3 (2011)

<sup>8</sup> Bureau of Labor Statistics, Consumer Price Index for All Urban Consumers (CPI-U), College tuition and fees, 1979-2011 (2012); Bureau of Labor Statistics, Consumer Price Index for All Urban Consumers (CPI-U), All Items, 1979-2011 (2012); Bureau of Labor Statistics, Median usual weekly earnings, Employed full time, Wage and salary workers, 1979-2011 (2012); Bureau of Labor Statistics, Consumer Price Index for All Urban Consumers (CPI-U), Medical Care, 1979-2011 (2012)

quality conforming mortgages and federal student loans originated in this time period were rather ordinary.

But, of course, not all mortgages were so ordinary, and phrases like “no-doc” and “Alt-A” were well-known in the subprime market. While student loans have been originated outside of the federal loan programs for years, private student loans boomed in the years leading up to the crisis.<sup>9</sup> From 2003 to 2007, the number of undergraduates who took out private student loans almost tripled.<sup>10</sup>

Fueled by investor appetite for asset-backed securities, many private student lenders reduced their underwriting standards and marketed directly (and sometimes heavily) to students. Holders of these securities likely did not expect the levels of delinquency and default on these loans.<sup>11</sup> Theoretically, the rating agencies who evaluated the securities would have served to police quality issues and align incentives of investors and issuers. That alignment appears, in retrospect, to have been imprecise.

Like the subprime mortgage industry, lax lending practices are far less common in the current environment. Most private student loans today are co-signed by creditworthy borrowers and have significant disclosure requirements.<sup>12</sup> But like the mortgage market, there are still cracks in the system that need mending.

Private student loans often lack repayment flexibility<sup>13</sup> when young graduates face a difficult labor market – a marked contrast to the federal student loan program. In 2007, Congress and President Bush enacted the College Cost Reduction and Access Act, which recognized the need for student loan borrowers to have an option to service their debt as a portion of their income.<sup>14</sup> The income-based repayment program allows a student loan borrower to remain current on a loan, so long as they are paying a fixed percentage of discretionary income; but this is generally not a feature offered to private student loan borrowers.

In addition, some for-profit colleges arrange institutional lending programs for students to borrow directly from the school or a school-affiliated entity. These companies report that they anticipate high levels of default on these loan portfolios.

Private student loan borrowers also experience significant challenges when attempting to restructure their loan obligations, due to an unusual status in the federal bankruptcy code and a nearly nonexistent refinance market.

Compared to other forms of consumer debt, like credit cards, private student loan debt is more difficult to restructure. In the bankruptcy code, distressed private student loan borrowers are put

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<sup>9</sup> Consumer Financial Protection Bureau and U.S. Department of Education: Report on Private Student Loans (2012)

<sup>10</sup> *Ibid.*

<sup>11</sup> *Ibid.*

<sup>12</sup> *Ibid.*

<sup>13</sup> Lenders have voiced that the offering of alternate repayment schedules is limited by prudential guidance, which might often require greater provisions for loan losses when granting modifications.

<sup>14</sup> P.L. 110-84

in the same category as those who cause injury when driving drunk, skip out on taxes, or avoid child support.<sup>15</sup>

Even some of the most responsible borrowers— those who may be making significant sacrifices to make payments on their private student loans— have sought help to better manage their debt burden. Despite a significant change in the interest rate environment, we see that many borrowers feel stuck in high interest rates and high monthly payments, because they cannot easily refinance.

### **Important Steps Forward in the CFPB’s First Year**

The CFPB has already begun to act to address concerns in this market. In March, we launched a student loan complaint system where borrowers can get help. Any consumer with a student loan can come to our website ([consumerfinance.gov](http://consumerfinance.gov)) or call our toll-free call center to get help. For borrowers with private student loans, we receive complaints directly from borrowers and, through our web-based portal, connect borrowers with their lender or servicer and work to resolve their complaints.

In our monitoring of the student loan market, as well as through what we hear in complaints and other feedback from borrowers, we observe many issues similar to those experienced by consumers in the mortgage servicing industry. For example, borrowers have told us about problems in the crediting of payments and processing of paperwork, confusion when financial institutions buy and sell portfolios of loans, and difficulty getting clear guidance from student loan servicing personnel when facing financial hardship.

Our complaint system has already helped many borrowers when faced with billing errors, lost paperwork, and other loan servicing issues. We will continue to monitor these servicing issues and plan to provide a report to Congress later this year.<sup>16</sup>

We also worked closely with the Department of Education on a Know Before You Owe “financial aid shopping sheet” to help schools provide better information on student loans and grants. And we’ve developed online tools, used by tens of thousands of consumers, on how to navigate their student loan repayment options, avoid default, and protect their credit history. We’ve also begun to supervise the nation’s largest banks, where much of today’s private student loan origination takes place, for compliance with federal consumer financial laws and to detect and assess risks to consumers.

The CFPB hopes to continue and expand our work with other agencies that might play a critical role in addressing roadblocks to facilitating repayment flexibility and a robust refinancing market.<sup>17</sup>

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<sup>15</sup> 11 U.S.C. § 523 (a)

<sup>16</sup> This report is pursuant to Section 1035 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.

<sup>17</sup> Consumer Financial Protection Bureau and U.S. Department of Education: Report on Private Student Loans (2012).

Congress can also play a role. Last week, CFPB Director Richard Cordray and Secretary of Education Arne Duncan presented a report to Congress on the private student loan market. Both Director Cordray and Secretary Duncan provided recommendations on potential improvements to the marketplace. They each asked Congress to consider requiring school certification of loans, modifying the definition of a private student loan, and further investigating whether the 2005 change to the bankruptcy code met its intended goals.<sup>18</sup>

### **Student Debt in the Broader Economic Puzzle**

Over the past year, the CFPB collected thousands of comments from individual student loan borrowers about their experiences with private student loans. A common theme in these stories was the impact of their debt on reaching economic milestones.

Compared to mortgages, student debt does not pose the same sort of systemic risk to the banking system. While policy makers are highly focused on conditions in the labor and capital markets, it would be imprudent to dismiss that growing student indebtedness can act as a drag on economic recovery.

Consider a private student loan borrower with a high interest rate (which could creep even higher given today's interest rates) on a large balance. Many borrowers are dutifully meeting these obligations. But without a robust refinancing market, they struggle to reduce their monthly payments, even though they might have built a solid credit history since their early days of college. Will these honest borrowers be precluded from reaching the economic milestones familiar to American life? And if so, what might be the broader consequences?

Take the housing market: first-time homebuyers are typically an important source of demand and help facilitate move-up purchases from existing buyers. Census data reveals that 6 million Americans ages 25-34 lived with their parents in 2011, a sharp increase from just a few years ago.<sup>19</sup> The 25-29 year old age cohort has experienced significant reduction in homeownership rates since the financial crisis.<sup>20</sup> The National Association of Realtors estimates that people aged 25-34 made up 27 percent of all home buyers in 2011, the lowest share in the past decade.<sup>21</sup>

A recent Federal Reserve Study shows the share of individuals age 29-34 getting a first-time mortgage dropped significantly in the past decade.<sup>22</sup> According to Chairman Ben Bernanke, "Lending to first-time homebuyers has dropped precipitously, even in parts of the country where unemployment rates and housing conditions are better than the national average."<sup>23</sup>

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<sup>18</sup> *Ibid.*

<sup>19</sup> U.S. Census Bureau: Families and Living Arrangements, Table AD-1, Young Adults Living at Home: 1960 to Present (2010)

<sup>20</sup> U.S. Census Bureau: Housing Vacancies and Homeownership (CPS/HVS), Table 15, Housing Inventory Estimates by Age of Householder and by Family Status: 1982 to Present (2011)

<sup>21</sup> National Association of Realtors: Profile of Homebuyers and Sellers (2011)

<sup>22</sup> Board of Governors of the Federal Reserve System: US Housing Market: Current Conditions and Policy Considerations (2012)

<sup>23</sup> Speech to the 2012 National Association of Homebuilders International Builders' Show (February 10, 2012)

It is not just the goal of homeownership that seems further out of reach. A recent report revealed that just 50 percent of workers under the age of 30 have enrolled in their employer's 401(k) plan.<sup>24</sup> Forty-three percent of young workers do not save enough to receive a full employer match,<sup>25</sup> and are more likely to cash out their plans when changing jobs.<sup>26</sup> The inability to afford making contributions to these employer plans can lead to significant reductions in future nest eggs, calling into question whether young, debt-burdened graduates will enjoy a retirement like previous generations of Americans.

While there are certainly many factors that could explain these trends, we might find continued economic stress for young graduates due to high debt levels -- even if the broader labor and capital markets improve significantly.

Congress<sup>27</sup> and federal agencies have taken steps to increase liquidity and the functioning of the credit markets in recent years, but the current conditions in the student loan market may have a long-term impact on the economic vitality of many student loan borrowers.<sup>28</sup> Many student loan borrowers today -- even those who are making large monthly payments on-time -- are unable to secure adequate credit accommodations to refinance or modify their debt burden, despite today's historically low interest rate environment.

Policy makers have paid significant attention to the refinancing and modification conditions in the mortgage market. But given the potential impact of student debt on the broader economy, the situation is rapidly demonstrating the need for attention to determine whether action is required.

The CFPB will continue its work to make the private student loan marketplace work better for borrowers, schools, and honest lenders. We look forward to working with Congress and policy makers to address risks in the marketplace and identify ways to ensure that economic mobility is still within reach for those who borrowed to invest in an education.

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<sup>24</sup> Northern Trust: Line of Sight: The Path Forward -- Engaging the Younger Employee in DC Plan Participation (2011)

<sup>25</sup> Aon Hewitt: Navigating the Path to Retirement: 2011 Universe Benchmarks Highlights (2011)

<sup>26</sup> Northern Trust: Line of Sight: The Path Forward -- Engaging the Younger Employee in DC Plan Participation (2011)

<sup>27</sup> In 2008, Congress enacted the Ensuring Continued Access to Student Loans Act, which gave the Department of Education the authority to provide liquidity to financial institutions originating student loans through the Federal Family Educational Loan Program. The Department of Education established programs, including a buyer-of-last-resort supported asset-backed commercial paper conduit, which purchased in excess of \$100 billion in student loans.

<sup>28</sup> It is worth noting that federal agencies have intervened in the private student loan market in recent years. Citing "unusual and exigent circumstances," the Federal Reserve Board of Governors exercised its authority pursuant to Section 13(3) of the Federal Reserve Act to establish the Term Asset-Backed Securities Loan Facility (TALF), which facilitated the issuance of a wide range of ABS, including those backed by private student loans.