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Subcommittee on Financial Institutions and Consumer Protection

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Hearing on Private Student Loans: Providing Flexibility and Opportunity to Borrowers

Good afternoon Chairman Brown, Senator Corker and Members of the Subcommittee. My name is Jack Remondi. I am the President and Chief Operating Officer of Sallie Mae. I thank you for the opportunity to testify on the private education loan marketplace, which has witnessed a significant transformation in recent years. More than ever, a college degree provides a pathway to a lifetime of higher income and employment. Yet, with today's cost, most families find they need to finance a portion of the total cost. Private education loans provide a small, but important, supplement for students and families that can help them access a higher education. In our 40 years, Sallie Mae has helped more than 31 million Americans achieve their college dream. As a result of our experience, Sallie Mae understands the importance of education, and how it can drive positive economic change for individuals and families across the economic spectrum. We take seriously our role of providing responsible private education loans to those who rely on them when making the college investment.

As the country's leading saving-, planning- and paying-for-college company, with the mission of helping make higher education accessible and affordable for American families, Sallie Mae is grateful for this opportunity to share our perspective in this discussion.

Overview

The market for private education loans is a small, but important, source of funding that helps students and families responsibly fill the gap between their own income and savings, financial aid, grants, federal loans, and the total cost of their chosen college or university. Created decades ago, at a time when available aid was not enough to meet the full cost of education, private education loans were introduced to support families in meeting remaining costs after other resources and were never intended to replace federal aid. In fact, they were originally called "supplemental" loans, indicating their stated purpose. We recommend that the Committee consider today's market in terms of size and providers, and its limited, but important, supplemental role in financing higher education.

In academic year 2007-08, students and families borrowed $23.2 billion in "non-federal," or private education loans, representing about 6 percent of all spending on higher education. With increases in federal loan limits, more robust underwriting standards and a very difficult economic environment, three years later, in academic year 2010-11, students and families borrowed less than $8 billion in non-federal education loans, representing about 1 percent of total spending on higher education.[1]

Over the same period, however, the federal loan program grew by 50 percent, from $69 billion to $104 billion.[2] Today, federal loan originations are 13 times that of private education loans.

We believe that education loans are not meant to be the sole source of higher education funding. In fact, we administer 529 college savings plans and interest-free tuition installment plans for millions of families. When those and other aid are not enough, families consider borrowing, and when they do, as with any loan, education loans should be taken out with care. Students and their families need to assess the total cost of education, not just the bill for the current semester, and be sure that what they borrow is what they can afford based on current and projected financial resources.

As a means for achieving economic success in America, a higher education is more valuable than ever. Various studies have estimated that college graduates will earn, on average, between $650,000 and $1,000,000 more over the course of their careers than those with only high school diplomas.[3] In addition to increased earnings potential, a higher education results in lower unemployment rates. National unemployment figures for June were at 8.2 percent;

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[1] College Board, "2011 Trends in Student Aid", McKinsey & Company
[2] College Board, "2011 Trends in Student Aid"
[3] Georgetown University Center on Education and the Workforce, August 2011.

however, Americans with a bachelor's degree or higher had a jobless rate of just 4.1 percent. The benefits of employment extend to new college graduates, as well. The unemployment rate of new graduates is 9.8 percent compared to 20.6 percent for their same-age peers with no post-secondary education.[4]

Higher education is a major lifetime investment and helping college-bound students and their families responsibly make this investment is Sallie Mae's top priority. Experience has taught us that a one-size-fits-all approach does not work. That is why we have developed a suite of tools and products that help students and families build plans that are right for their situations and that will assist them whether college is a long way off or right around the corner.

Our goal is to educate families up front about the entirety of the education finance process, and to make sure that access yields success. Families will be their own best defense against over-borrowing if they keep these basic principles in mind:

- Choose a school that is within financial reach.
- Create a financial plan that goes beyond the first year and includes all the expected costs through graduation.
- Consider career plans and likely starting salary in the borrowing decision.
- Remember that loans require repayment.
- Explore federal loans first.
- Keep balances down by doing whatever can be done to make loan payments while in school.
- Make loan payments, even partial ones, if at all possible when out of school to keep balances from growing out of control. Deferring payment is the same as borrowing more – the loan balance grows every day.
- Perhaps most important of all, graduate. Nobody wins when debt is incurred for a degree that does not materialize. Student loans without a degree mean loan payments without the increased employment prospects and higher earnings to support them.

[4] Bureau of Labor Statistics, Current Population Survey, June 2012.

Sallie Mae has a long-standing practice of advising a “1-2-3 approach” to paying for college to empower families to make informed decisions. Specifically, we recommend that families do the following:

1. Use scholarships, grants, savings and income.

2. Explore federal loans.

3. Consider an affordable, responsible private education loan to fill any remaining gap.

The Administration’s recent report on private education loans stated, “Students and their families would be better served by having access to all pertinent financial information concerning the college decision prior to deciding which college to enroll at and how much debt to incur.”[5] Sallie Mae couldn’t agree more. Although applying for financial aid is an annual exercise, we encourage families to plan for the multi-year commitment required to fund a college degree. In fact, we design our planning tools to assist families in determining how to meet the full costs of a college education. A one-year snapshot is simply not enough.

Our free Education Investment Planner gives families the tools and information they need to become educated planners and savers. The free tool helps users “know what they will owe” over the entire course of completing their college degree, and assess before borrowing whether that amount will be manageable given their current and expected future income.

In most cases, higher education is a family commitment. Sallie Mae’s *How America Pays for College* research found that three out of four families believe parents and students should share the responsibility for paying for college. In practice, six out of 10 parents contribute, either through savings or borrowing, to fund their children’s educations. Our private education loans are designed to support that shared responsibility and commitment. Last year, over 90 percent of our new private education loans had a cosigner, usually a parent.

At Sallie Mae, efforts to inform students and families about their loans begin at loan application and continue until the loan is paid in full. During the application process, students and their cosigners view monthly and total payment information customized to their borrowing

[5] Consumer Financial Protection Bureau and Department of Education, “Private Student Loans,” July 2012.

amount and qualifying interest rate. Applicants are presented with a choice of interest rate structure, variable or fixed, and a choice of repayment options that include in-school payments of interest, nominal payments of $25 a month or deferred payments.

Once approved, customers receive multiple disclosures with detailed loan information. These communications clearly highlight the availability of federal loan programs, quantify expected monthly payments and finance charges, encourage the applicant to shop around, and outline the right to cancel the loan after disbursement.

The education process continues after loan proceeds are disbursed. Our private education loan customers receive statements monthly that detail their loan balance and accruing interest. Customers who elected to defer payment while in school are reminded of the effect that making in-school payments would have on their total loan costs. This continuing education has been successful, and we are pleased that so many of our customers have benefitted from this cost-saving practice.

Sallie Mae's private loan portfolio is strong, and our underwriting is sound. Even in these tough times, the vast majority of our customers are successfully making on-time payments. In fact, 90 percent of our loans in repayment are current. Our private loan delinquencies have steadily declined since the peak of the recession, and charge-offs have dropped from a high of 6 percent of loans in repayment to 3 percent this year.

Still, we recognize that the economic recession has posed real and significant challenges for some of our customers. Our success depends on our customers' success, and therefore, we are committed to working with customers to help them navigate difficult financial circumstances and preserve their good credit standing. To assist borrowers with past due loans, we reach out to gain an understanding of the individual circumstances they face. To customers who have exhausted traditional repayment options and are demonstrating a reduced ability to pay, we offer a mix of repayment products, counseling and collection programs that give them the best opportunity to manage their debt obligations and succeed. These options include reduced monthly payments, interest-only payments, extended repayment schedules, and temporary interest rate reductions, all scaled to a customer's individual circumstances and ability to make manageable payments. Since 2009, we have modified $1.1 billion in loans to help our customers manage their loans.

Nonetheless, in some cases, loan modifications and other efforts are insufficient and bankruptcy may be the only path. Sallie Mae supports reasonable reform to bankruptcy laws that would allow borrowers to discharge their education loans—both private and federal—after a good faith period of attempting to repay. Any reform must recognize that education loans have unique characteristics and benefits. They are unsecured credit extended to borrowers whose assets are initially limited, but can be expected to grow over a lifetime of greater earnings power attributable to the value provided by the education obtained through these loans. Consequently, given the lifelong nature of this "collateral," Congress saw fit that neither private nor federal loans be easily dischargeable in bankruptcy. This has been the case for federal loans since the late 1970s. Private education loan rules, which had mixed treatment depending on the lender/guarantor, were standardized with the same protection in 2005.

Recent graduates with sizable education loans and relatively few assets, a common combination in education lending, create a moral hazard that drove the creation of these bankruptcy protections. "Many Students Avoiding Payment of Loans by Filing for Bankruptcy" was a 1976 *New York Times* headline about this unique problem. As graduates become employed, increase their earnings and assets and recognize the value of establishing good credit, this hazard diminishes. Sallie Mae supports bankruptcy reform that would require a period of good faith payments, that is prospective so as not to rewrite existing contracts, and that applies to federal and non-federal education loans alike.

Education loans are an important financial tool for responsible borrowers. They help provide access to a brighter future. Responsible lending standards, clear information and consistent laws are good for borrowers and lenders alike. We take this point seriously. Sallie Mae is ever mindful that our success is tied directly to the financial success of our customers, and our products and practices reflect that reality.

Our loans provide important protections for the family, including tuition insurance, and death and disability loan forgiveness. But the best protection inherent to any loan, including a private education loan, is the underwriting of the loan itself. Further, we all have a role to play in preventing over borrowing and working to assure as many students graduate as possible.

In the last five years, the private education loan marketplace has undergone significant change. Driven by the credit market crisis and changes at the state and federal levels – including changes developed by Congress – today's smaller private education loan marketplace provides extensive disclosures, adherence to new rules for financial aid offices, and tightened underwriting standards that better match loans with a family's ability to repay.

As you examine the private education loan marketplace, we hope Congress will recognize the comprehensive series of legislative and marketplace changes implemented in recent years that strengthened consumer protections and witnessed product innovations that have reduced costs for borrowers.

It is a mistake to believe "private" or "non-federal" is synonymous with "un-regulated." The private education loan marketplace is extensively regulated. The vast majority of private education loans are made through highly regulated traditional banking channels, to borrowers protected by numerous state and federal consumer lending laws. As the Consumer Financial Protection Bureau and U.S. Department of Education noted in their report:

> "Private Student Loan borrowers have significant protections under the Truth-in-Lending Act (TILA), the Equal Credit Opportunity Act (ECOA), the Fair Credit Reporting Act (FCRA), the Fair Debt Collection Practices Act (FDCPA), the Federal Trade Commission Act (FTCA), and the Consumer Financial Protection Act." (p. 67)

The Higher Education Opportunity Act of 2008 amended the federal Truth-in-Lending Act to establish a series of extensive, modernized disclosures to provide private education loan borrowers clear, consistent, and easy-to-compare information about private loans. Quoting again from the report:

> "The new Truth in Lending Act (TILA) disclosures for Private Student Loans are unique to that product. No other installment loan is subject to quite so much disclosure." (p. 68)

Also, the private education loan marketplace operates in accordance with important common safeguards to private education loans that were developed by Congress and passed as part of the Higher Education Opportunity Act of 2008. The HEOA established borrower protections such as a guaranteed 30-day window to accept the loan without term changes and the right to cancel loans after approval; it limited certain practices, such as school co-branding; it regulated campus lender lists; and it required borrowers to self-certify their costs of education and to confirm they are aware of the availability of federal loans before completing their private education loan applications.

As a result of the Dodd-Frank Wall Street Reform and Consumer Protection Act, rulemaking authority under many of these laws and regulations has been transferred to the Consumer Financial Protection Bureau. We have been working with the CFPB, including participating in their recent study, to ensure that consumers have access to responsible education loan products that not only help provide access to higher education, but also are designed to help produce success.

At Sallie Mae, our disclosures provide borrowers clear, consistent, and easy-to-compare information about private education loans.[6] These disclosures inform borrowers of the potential life-of-loan costs and provide multiple reminders to explore the availability of lower-cost options, including federal loans. In the most recent findings of our *How America Pays for College* study, we found how effective these reminders are:

- Of private education loan borrowers, 98 percent filled out the Free Application for Federal Student Aid form, or FAFSA, which is the first step toward taking out a federal loan.
- Last year, 25 percent of students borrowed federal loans only, 9 percent used a mix of federal and private loans, and 1 percent tapped private loans only.

[6] Examples of these disclosures are available at www.SallieMae.com/primer.

We believe that these significant results are directly related to the increased disclosures provided to consumers. In addition, Sallie Mae has pioneered new products and procedures designed to further help families make more informed, affordable choices.

Today, most private education loans are certified by the school. Sallie Mae advocates school certification as an important safeguard against over-borrowing; we will not disburse a private education loan until the school financial aid office certifies the need for and the amount of a loan. This is not because we are required to – we are not – but because it is an important check against over-borrowing.

Until three years ago, nearly all borrowers deferred loan payments while in school. In 2009, Sallie Mae became the first national lender to encourage payments while in school. In addition, we designed shorter repayment periods based on loan amounts, which, combined with in-school payments, dramatically reduce finance charges.

We encourage payments before graduation because it saves thousands of dollars over the life of the loan, and we reward customers who elect an in-school payment option with lower interest rates. Our in-school customers who opt for either the interest payment plan or the fixed $25 per month plan can save an estimated 30 to 50 percent in total interest costs.

In academic year 2011-12, when offered the choice of three repayment options, including no payments while in-school, 63 percent of Sallie Mae in-school customer families choose to lower their costs of borrowing by making payments. This compares to just 5 percent of customers who made in-school payments before we introduced the practice of encouraging them.

One area where we are anxious to see some change is in the area of working with defaulted borrowers. For those who have defaulted on their federal loans, the federal rehabilitation program provides a powerful incentive to borrowers to return to regular repayment and rebuild their credit. Under this program, if a customer makes a specified number of timely payments, his loan is “rehabilitated” and, by law, the default must be removed from his credit history. The statute requires the lender to report this change to the credit history. For all other consumer credit, however, the Fair Credit Reporting Act does not allow such a “second chance.” There is no provision for lenders to rehabilitate defaulted private loans and then request the removal of a default that did, in fact, occur. For some time, we have identified the need for a similar rehabilitation solution. We believe it is appropriate for Congress to consider legislative changes that could provide this option to private education loan borrowers.

Conclusion

Higher education is an American priority, and how to pay for college is a family decision. Families will maximize the return on their investment when students graduate; thus, they should approach paying for college as they would any other serious investment: by understanding the full cost and the expected return.

Sallie Mae has long recommended that students and their families finance higher education from savings, scholarships, grants, federal student loans, and, if necessary, a responsible private education loan.

Private education loans are a small but critical component of how families pay for college. Used by just 10 percent of families, private education loans help families cover the gap between other financial aid and their chosen school’s cost of attendance.

Legislative changes and market forces have combined to make private education lending better understood by families, better underwritten, and more targeted to provide the needed financing that can be the difference between achieving an academic goal and failing to do so.

Sallie Mae is proud to have helped more than 31 million Americans achieve their dream of a higher education. We pledge to continue responsible lending practices and to work with policymakers where there are opportunities to make further improvements.

Thank you. I would be pleased to answer any questions you may have.