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TURMOIL IN U.S. CREDIT MARKETS: IMPACT ON THE COST AND AVAILABILITY OF STUDENT LOANS

HEARING

BEFORE THE

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

ONE HUNDRED TENTH CONGRESS

SECOND SESSION

ON

EXAMINING THE IMPACT OF THE CURRENT CREDIT MARKET TURMOIL ON THE COST AND AVAILABILITY OF STUDENT LOANS

TUESDAY, APRIL 15, 2008

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C O N T E N T S

TUESDAY, APRIL 15, 2008

	Page
Opening statement of Chairman Dodd	1
Opening statements, comments, or prepared statements of:	
Senator Shelby	4
Senator Reed	5
Senator Corker	6
Senator Casey	6
Senator Martinez	6
Senator Johnson	
Prepared statement	43
Senator Dole	
Prepared statement	45

WITNESSES

John F. Remondi, Vice Chairman and Chief Financial Officer, Sallie Mae, Inc.	8
Prepared statement	47
Response to written questions of:	
Senator Casey	121
Senator Enzi	122
Tom Deutsch, Deputy Executive Director, American Securitization Forum	10
Prepared statement	55
Response to written questions of:	
Senator Casey	124
Senator Tester	126
Senator Enzi	126
Patricia McGuire, President, Trinity Washington University	11
Prepared statement	61
Sarah Flanagan, Vice President for Policy Development, National Association of Independent Colleges and Universities	14
Prepared statement	73
Response to written questions of:	
Senator Casey	128
Senator Tester	130
Senator Enzi	130
Mark Kantrowitz, Publisher, FinAid.org	16
Prepared statement	93
Response to written questions of:	
Senator Casey	133
Senator Tester	135
Senator Enzi	136

ADDITIONAL MATERIAL SUPPLIED FOR THE RECORD

Prepared statement of Dr. Philip Day, President and CEO, National Association of Student Financial Aid Administrators	138

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TUESDAY, APRIL 15, 2008

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The committee met at 10:06 a.m., in room SD–538, Dirksen Senate Office Building, Hon. Christopher Dodd, chairman of the committee, presiding.

OPENING STATEMENT OF CHAIRMAN CHRISTOPHER J. DODD

Chairman DODD. The committee will come to order. Let me begin by thanking all of our witnesses who are here this morning. We appreciate very much your attendance, and I have got a few opening comments to make. I will turn to Senator Shelby for any opening comments he wants to make. It is good to see we have some membership here and I will ask them if they have any brief comments they would like to make. We will keep the record open, obviously, for all statements that people want to include, including those by the witnesses, as well, additional supporting data or material you may want to offer to this committee for its consideration.

This morning, the committee is going to examine the issue of student lending. Approximately 1 year ago in this very room, I asked a Governor of the Federal Reserve Board a very simple question. I said, would subprime mortgages, would the meltdown in that market spread to other sectors of our credit markets. The answer I received that morning was, no, it is not going to happen. Well, we on this committee were told that the crisis was contained. That exact word was used. Nothing more to worry about.

Now we know that such a view was little more than wishful thinking. Predatory lending practices, which the Fed did little, if anything, to stop, I would add, poisoned the well of mortgage-backed securities, and as a result, investors are by and large declining to draw from that well and they are leery of drawing from other wells, as well, like the well for student loans. The result is a serious contraction in student loan credit that could result in a contraction of families' ability to finance the education of their children, or their children themselves to finance their own education.

This is not the only area this has affected. This contagion effect now is spreading across our economy. This morning, we are going to talk about this one area, but it isn't limited to this area. It is affecting every other aspect of our economy.

In recent months, over 50 lenders of federally guaranteed loans, including some of our nation's largest originators of Federal Stafford and PLUS student loans and nearly 20 additional private student loan issuers have indicated that they intend to suspend their lending activities. State loan guarantee agencies in Pennsylvania, Michigan, Montana, and Texas have also effectively posted their own "closed for business" signs and indicated that they, too, plan to exit the student loan-making business.

Combined, these lenders represent nearly 15 percent of the federally guaranteed loan market and make up about two-thirds of the loan consolidation business. A total of about $8 billion—that is what that 15 percent represents—is now out, not going to be there in the coming weeks and months for students and their families to access to finance their higher education as lenders find themselves cutoff from access to traditional sources of funds in the debt markets.

Some experts believe that this is just the start of an even larger exodus of lenders from the student loan market, and while I am unaware of an instance to date when a student has been unable to secure a loan, the withdrawal of these lenders, the ongoing turmoil in the U.S. credit markets, and the illiquidity in the student loan market have fueled concerns that a potential student loan credit crunch may be looming, one which could leave millions of students in a last-minute dash to secure financial assistance they need to attend college this academic year.

In fact, the supply of student loans is dropping at a time when student loan applications are rising. We are told already there is a 20 percent increase in the application for student loans. Now, whether or not those numbers hold throughout the coming months or not, I can't say with absolute certainty, but if an early indication is any indication of where we are headed, if the applications are up, you take out $8 billion already from that market and you don't have to have a Ph.D. in mathematics to know the kind of problems we are facing in this area.

A well-functioning and efficient post-secondary educational financing market is not only in the interest of young people, it is also in the interest of our nation, obviously. Ensuring that students have available and affordable access to a higher education should be among our highest priorities as a nation. Our world is growing more complex by the day, as we all know. Never before in the history of this country has a higher education been more crucial to the success of our nation than it is today.

Sixty percent of the new jobs being created by our economy require at least some post-secondary education. Compare that to a half-century ago. In fact, you need not even go back that far, but a half-century ago, only 15 percent of the new jobs created in those days required some amount of higher education. If our children are to achieve, obviously, their highest aspirations and the aspirations parents have for their children, and if our nation's economic backbone is to continue to remain strong, then we must ensure that the doors of higher education remain open for all who have the desire and ability to walk through them.

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 it. Over the past two decades, the cost of attaining a college degree has risen approximately twice the rate of inflation. It is bad enough that it would increase at inflationary rates, but twice the rate of inflation. That is a staggering fact that has posed even a larger burden on lower- and middle-income families in our country.

Today, of course, as many of you may know, the average cost of attending a public institution of higher learning is roughly $13,000 a year. The average cost of a private institution is more than double that, around $30,000 a year, while some schools are costing as much as $50,000. In fact, in this very city, I think if you looked at the institutions in Washington, D.C., in this community, I think the number is well in excess of $30,000 a year for most of the private institutions.

For most students, educational loans, primarily federally guaranteed loans, and to a lesser degree private loans, bridge the gap between traditional funding sources, like scholarships, grants, and other forms of free financial aid, and skyrocketing tuition costs. According to the Department of Education, seven million borrowers will seek close to $70 billion in federally guaranteed loans this year. Millions more will seek up to $20 billion in private educational loans to bridge that gap. The total is obviously between $90 and $100 billion. That is a staggering number and it demonstrates how reliant students have become on loans, like the low-cost FFELP loan program, to help meet their educational financing needs in the face of skyrocketing tuition costs.

While in an ideal world, no student would ever have the need for an educational loan, we should ensure that so long as the need remains, we will do all that we can to ensure that educational loans are both available and affordable. So I look forward to today's hearing and listening to our witnesses regarding the current conditions in the student loan market and what, if any, steps can be taken to prevent today's concern from becoming tomorrow's full-blown crisis.

So while we are not in a crisis, and I want to emphasize that this morning, that those words ought to be used very, very guardedly, this is not a crisis, but we are on the cusp between concern and crisis, and that is a fact. So this morning's hearing has value to highlight exactly where we are in this. It is not unlike where we were a year ago in talking about the residential mortgage concerns. Those concerns did explode into a crisis that we are in today because the words like "contained" and the market was going to take care of this and all the other language we heard, it didn't solve the problem, or steps were not taken. So while we are gathering today to talk about a concern, I think we would be terribly misguided if we didn't appreciate where this could end up very quickly if we don't step up to the plate and take steps to reduce that possibility.

To that end, I will be sending a letter to Secretary Paulson today asking him to consider using the Federal Financing Bank to help prime the pump of liquidity in order to help avert a funding crisis in the student loan market. I haven't had a chance to share this letter with Senator Shelby, which I will do, and obviously he will have to evaluate whether he wants to be on it with me, but hopefully he may join, and others, by the way, on the committee who

may want to join us in that piece of correspondence, we would invite their taking a look at it to decide whether or not they want to be a part of it.

We will also be writing to the Fed Chairman asking him to use all of the existing tools to avoid a breakdown in the market for student loans, including federally backed and AAA-rated private student loans to be used as collateral at the Fed's temporary secured lending facility. And I invite my colleagues, as I said a minute ago, to enjoin in that effort.

Last month, the Treasury and the Fed demonstrated their willingness and ability to take strong action to preserve liquidity and order in the capital markets. Their actions were unprecedented, as we all know, but so are the times in which we find ourselves today. It would be a mistake, in my view, for anyone to think that this crisis has passed. If the Fed and the Treasury can commit $30 billion of taxpayer money to enable the takeover of Bear Stearns by J.P. Morgan Chase, then certainly they can step in to enable working families to achieve the dream of a higher education for their children. If they do not, then I stand ready, as I am confident my colleagues would, to act legislatively to prevent a deepening of this crisis in this area.

Last, I just want to mention, as we were talking earlier, in the—is it the Student Loan PLUS Program, is that correct? Something many of you may know here, the witnesses, but we have discovered there is a provision where if a family has been in foreclosure of their home in the last 5 years, then you are disqualified from that PLUS program. So when you want to know whether or not these issues, there is a cross-contamination, if you will, and if you are one of the 8,000 people today in this country who will file for foreclosure every day, if you have a 14-year-old child today and you are filing for foreclosure, your family is then precluded under existing law from qualifying for that kind of student help 5 years from today.

And so these problems are serious and they are growing, and it is not enough to sit around and just wring our hands, in my view. We need to be doing more in this regard.

So with that, let me turn to Senator Shelby.

STATEMENT OF SENATOR RICHARD C. SHELBY

Senator SHELBY. Thank you, Mr. Chairman. With the bulk of student loan origination occurring between May and early July, many students will be seeking loans to help pay for college. The turmoil in the credit markets has impacted almost every aspect of consumer lending, including student lending. In order to obtain a complete understanding of the problems in the student loan market, I believe we must examine both Federal and private lending.

There are two main problem areas with Federal educational loans. First, non-depository institutions, such as Sallie Mae and Nelnet, are having difficulty obtaining funding because the auction rate securities market and the securitization process has slowed considerably.

The second problem is that depository institutions are no longer allocating resources to student lending because it is not profitable. With liquidity problems rising and profitability diminishing, there

are fewer resources available to fund student loans in this country. The situation in the private loan market is less complex because institutions are able to pass the cost of funds on to individual borrowers. That said, because credit has become tighter, underwriting has also become tighter. Borrowers at community college, for-profit institutions, and those who lack a co-borrower will be hardest hit in the private student loan market as loans become less available and more costly.

What does all this mean for students? Some students will not be able to obtain loans, while other students will seek the efficiency of the private student lending market and will miss the opportunity to obtain Federal funding. Many other students will not be able to refinance and take advantage of the favorable interest rate environment we have today.

Some have advocated that the Direct Loan Program should be used as a way to bridge the gap both for loan originations for the upcoming academic year as well as a way to help students consolidate their obligations. This program, however, has historically only achieved about 20 percent market share. Therefore, even assuming the Direct Loan Program could double their current market share, there is still a large gap that must be addressed.

Many of our witnesses here today have put forth solutions. I am concerned that nearly all of the solutions require some degree of government intervention in the market. What will all of this really cost the taxpayer here? How will this affect innovation in the marketplace? At some point, I believe we must ask the institutions of higher learning to be part of the solution by stabilizing or even decreasing the cost of tuition where possible.

Finally, Mr. Chairman, we must ensure that short-term solutions continue to work when the markets stabilize.

I appreciate you holding this hearing today.

Chairman DODD. Thank you very much, Senator.

Let me turn to my colleagues. Jack, do you have any opening quick comments you want to make, and if you have any quick comments, as well.

STATEMENT OF SENATOR JACK REED

Senator REED. Mr. Chairman, thank you very much. Just very quickly, working on the Education Committee with you and many colleagues here, we tried to expand the access to student loans supported by the Federal Government, but still there is a huge demand for private loans. The number is staggering. Ten years ago, it was about $1.57 billion, and in 2006–2007, $17 billion in private loans, so it is a staggering amount of money and we have to make sure that these funds are available. That goes to the issue of the liquidity, the funding of these loans, the underwriting standards, the issue of how much counseling these individuals are getting.

So this is a very valuable hearing and I appreciate the opportunity to participate. Thank you.

Chairman DODD. Thanks very much.

Senator Corker, any quick comments at all?

STATEMENT OF SENATOR BOB CORKER

Senator CORKER. Just that it is amazing how this option rate security issue is rippling through every segment of our society. I think this hearing is most timely. We have outstanding witnesses and I look forward to hearing from them.

Chairman DODD. Thanks very much.

Bob, good morning.

STATEMENT OF SENATOR ROBERT P. CASEY

Senator CASEY. Good morning, Mr. Chairman. Thank you very much. I will be very brief.

But just to reiterate what a number of colleagues have said, this credit crisis and the foreclosure challenge that we have had is having ripple effects all across the country. Now we are dealing within the context of student loans. It is hard to comprehend that it could get to this point.

But we are grateful for the hearing. We are looking forward to the testimony of the witnesses. We appreciate their presence here. Thank you.

Chairman DODD. Thank you. I mentioned, in fact, that in Pennsylvania, the student loan agency is one of the four or five States that has already indicated how serious the problem could be.

Mel.

STATEMENT OF SENATOR MEL MARTINEZ

Senator MARTINEZ. Mr. Chairman, thank you. This is a very timely hearing. I am the recipient of student loans and I would otherwise not have gotten through college if I hadn't had them available. I am very sympathetic and understand the problem.

It also comes with a backdrop that as a Floridian, we are looking at significant shortfalls in education funding which could then lead to a rise in tuition for State universities, and so it is very timely. I appreciate you holding this hearing and I look forward to hearing from this excellent panel.

Chairman DODD. Thanks very much, and let me introduce our good panel. We thank them for being here.

Jack Remondi is the Vice Chairman and the Chief Financial Officer of Sallie Mae and oversees all of the company's business strategy and is responsible for corporate finance, investor relations, accounting and reporting, financial planning, credit policy, risk management. He originally joined Sallie Mae in 1999 as a Senior Vice President and Treasurer as part of the acquisition of Nellie Mae, where he served as Executive Vice President of Finance from 2001 to 2005. He worked as a portfolio manager of PAR Capital Management, a Boston-based private investment management firm, before rejoining the company in January of 2008. Prior to Sallie Mae, Mr. Remondi served as the Chief Financial Officer and the Senior Vice President of Corporate Finance and Administration for Nellie Mae. Anyway, we thank you for being here.

Tom Deutsch is the Deputy Executive Director of the American Securitization Forum. He handles coordination and implementation of the organization's securitization market advocacy initiatives. Previously, he served as an associate in the Capital Markets Department of Cadwalader, Wickersham and Taft, where he rep-

resented issuers and underwriters in various structured finance offerings, including residential mortgages, backed securitizations, and asset-backed securitizations. We thank you for being here.

Patricia McGuire is the President of Trinity University. I should point out this is an institution that I have a particular fondness for and that has produced three of the most influential women in my life, I might add. My mother, my sister, and my sister's classmate, a young gal by the name of Nancy D'Alessandro went to Trinity College. Nancy D'Alessandro, of course, is the Speaker of the House today, Nancy Pelosi, and so I am delighted to have you here with us this morning.

President McGuire has been the President of Trinity since 1989. Before becoming President, she was the Associate Dean for Developmental and External Affairs at Georgetown University Law Center. She was also an adjunct professor of law. She earned her Bachelor of Arts degree cum laude from Trinity College and a law degree from Georgetown University, and thank you for being with us.

Sarah Flanagan is the Vice President of the National Association of Independent Colleges and Universities. She is no stranger to the Senate, having worked for me a number of years ago. Welcome back to the Senate, Sarah. It is good to see you again. She was the Staff Director of the HELP Committee's Subcommittee on Children, Families, Drugs, and Alcoholism, and before that, she worked for Senator Claiborne Pell of Rhode Island. Sarah directs the comprehensive government relations effort in coordination with related State associations that focuses on issues of government regulation, student financial assistance, and tax policy. Before joining the Education Committee, Sarah Flanagan worked for Close-Up Foundation as an instructor, a teacher, trainer, and curriculum panelist. We are delighted to have you here with us this morning.

Mark Kantrowitz is the Publisher of FinancialAid.org and Director of Advanced Projects for the FastWeb, a Monster company. He is ABD on a Ph.D. in computer science from Carnegie Mellon University, has Bachelor of Science degrees in mathematics and philosophy from MIT, and a Master of Science degree in computer science from CMU. He is also an alumnus of the Research Science Institute Program established by Admiral Hyman Rickover. He has previously been employed at Just Research, the MIT Artificial Intelligence Laboratory, the Center for Excellence in Education, and a variety of other positions. We are delighted to have you here with us, Mark, this morning.

Senator SHELBY. Mr. Chairman, we should have been sitting next to him in class.

[Laughter.]

Chairman DODD. Or at least had access to what he was writing down on the test paper along the way.

Senator SHELBY. Right.

[Laughter.]

Chairman DODD. I had all these acronyms here, I probably mispronounced half of them for you, but Mark, thank you for joining us.

We will begin with you, Jack. What I will ask you to do, if you can, is try and keep your remarks to five, six, 7 minutes. I am not going to bang the gavel on you. Your full statements, any sup-

porting data you think would be helpful for us to have a fuller appreciation of what you are going to share with us this morning, I promise you will be included in the record.

STATEMENT OF JOHN F. REMONDI, VICE CHAIRMAN AND CHIEF FINANCIAL OFFICER, SALLIE MAE, INC.

Mr. REMONDI. Good morning, Chairman Dodd, Ranking Member Shelby, and Members of the Committee. My name is Jack Remondi and I am Vice Chairman and Chief Financial Officer of Sallie Mae. Thank you for the opportunity to testify before you this morning.

Over the last decade, the cost of college education has increased dramatically. Today, students and families rely more than ever on Federal student loans to meet this cost. Often, however, the amounts available under this program are not enough. Increasingly, credit-based or private student loans have helped families close this gap between State and Federal aid, scholarships, limited family resources, and the actual cost of attending college.

This year, we expect the demand for education loans to be even higher, yet both Federal and non-Federal student loan markets are under severe stress. For the current academic season, we are facing a scenario where the demand for student loans will significantly outstrip the supply.

I would like to describe Sallie Mae's recent experience in the student loan finance markets and to recommend action the Federal Government can take to restore liquidity for this primary source of paying for college.

The financing of Federal student loans is relying on a well-functioning, well-priced credit market. This is clearly not the environment we operate in today. The compensation demanded by investors has increased rapidly and significantly since mid-summer of last year. Current funding levels have increased more than 14 times to LIBOR-plus-140 basis points, with these spreads doubling in the past 6 weeks alone. These are levels never seen before for this asset class. For non-Federal loans, the situation is even worse.

Because of the market disruption, there have been no term asset-backed securitizations for private student loans this year. This unprecedented cost of borrowing added to the 70 basis point yield cuts contained in last year's College Cost Reduction and Access Act mean that every Federal loan originated today will be made at a loss, even before operating expenses.

Because of these economics and limited access to funding, upwards of 50 lenders have already ceased or suspended making student loans. To put it simply, absent any liquidity and price relief, we are looking at a material shortfall in access to student loans this year.

Given the seasonal nature of lending, students and schools are only beginning to feel the impact on loan availability. Demand is always low in the first quarter of the calendar year, but increases significantly as over 75 percent of all student loans are made in the next 6 months.

It is our view that the gap between supply and demand is beginning to show. Although it is early, new loan applications to Sallie Mae are up 26 percent this month over last year, a pace that we have made clear, due to the access issues, that we cannot fund.

Despite the significant loss incurred on each new Federal loan made, many lenders, including Sallie Mae, have continued to lend as they await a resolution addressing both access to liquidity and margin. If there is no action taken to address this impending crisis, all Federal loan lenders will be forced to ask, why are we continuing to make loans at a loss?

We do, however, have a recommended solution where the Federal Government could take budget-neutral steps to avert a student loan crisis. Our view is that priority should be given to temporary steps that are non-disruptive to students and schools and are operationally viable to guarantee borrower access to loans this academic year.

In our opinion, the least disruptive, most cost effective, most controllable, and quickest proposal to implement would be for the Department of Treasury's Federal Financing Bank to provide liquidity for federally guaranteed loans. The Federal Financing Bank is already authorized by statute to purchase and sell any obligation issued, sold, or guaranteed by a Federal agency. Therefore, legislative action is unnecessary to make this happen. Upon exercise of this authority to make funding available for new loans, the program would be up and running quickly.

We believe this plan would ensure that student access to Federal loans is undisrupted. But such an action would do more than that. It would be a signal to the market that the government stands behind this vital program, and we believe would hasten a return of investors to this asset class.

With front-page articles beginning to appear in the nation's newspapers detailing concerns about access to student loans, this plan would also help restore consumer confidence because parents and students would know that they could attend college as planned this fall.

Most important for the subject of this hearing today, I believe that creating liquidity for Federal loans would have a spillover benefit to the non-Federal or private market, as well.

There are other proposals under consideration, such as authorizing the Federal Home Loan Bank System to take Federal student loans as collateral for advances and allowing primary dealers and issuers to use student loan asset-backed securities as collateral to borrow from the Federal Reserve's newly created Term Securities Lending Facility. I look forward to discussing these, as well, in the course of this hearing.

In conclusion, the financing environment for student loans is under unprecedented pressure due to the combination of legislative cuts and severe dislocation of the asset-backed and auction rate securities markets. Action is needed now to prevent a crisis of student access to Federal and private education loans. We do not have months or even weeks to decide the best course of action. The administration can and should move immediately to make available advances from the Federal Financing Bank. This action is needed to avert the impending crisis. We hope Congress can urge them to do so without delay.

Thank you for allowing me to appear and I look forward to answering any questions you may have.

Chairman DODD. Thank you very much.

Mr. Deutsch.

STATEMENT OF TOM DEUTSCH, DEPUTY EXECUTIVE DIRECTOR, AMERICAN SECURITIZATION FORUM

Mr. DEUTSCH. Good morning, Mr. Chairman and Ranking Member Shelby. Thank you very much for having us participate in this session. My name is Tom Deutsch and I am the Deputy Executive Director of the American Securitization Forum. I very much appreciate the opportunity to testify here today before this committee on behalf of the 375 member institutions of the American Securitization Forum and the 650 member institutions of the SIFMA. Our members include not only the firms who originate and securitize most of the student loans made in America, but also the institutional investors, such as pension funds and mutual funds, who purchase the securities backed by these student loans

Over the last 40 years, four strong pillars have supported the success of the innovative FFELP program that is a critical public-partnership to provide education loans to America's youth. These four pillars include, one, a low-cost, efficient funding mechanism that capital markets have supplied to lenders of student loans through the capital markets and securitization process. Two, there have been appropriately sized incentives to lenders in the form of government principal and interest guarantees and special allowance payments. Three, it has been a robust market competition among student loan lenders that keep lender rates low and borrower benefits high. And four, there has been universal availability of FFELP loans to all potential students.

Unfortunately, though, the incentive reductions during the peak of the credit cycle in 2007 have made origination of student loans uneconomical to a large portion of the student lending market in today's credit-constrained capital markets. The combined force of these events over the last 6 months now threatens the support of each pillar of the FFELP lending program and hence the overall structure of the program.

Beyond FFELP lending, private student loans also help bridge the educational financing gap between Federal student loan limits and the ever-increasing costs of education in the United States. Much like the FFELP lending program, private student loan securitizations have also fallen on hard times these days. Over the past 6 months, turmoil in the debt capital markets, including significant repricing of credit risk, deleveraging of balance sheets, and failures in the auction rates securities market has eliminated economical access to the capital markets for many lenders.

Three of the most basic indicators of this turmoil include: One, no student loan originated after September 30, 2007, has been funded through the capital markets. Two, for the first time in 40 years, no State agency or nonprofit has been able to access the capital markets in the first quarter of 2008. And three, originators of private student loans have not been able to access the traditional securitization markets since September of 2007.

But for those lenders with access to capital market funding, they are finding significantly higher costs that they cannot recoup. Spreads on AAA-rated student loan ABS backed by FFELP loans have widened by nearly 150 basis points, or roughly 15 times the

level seen just last summer. Unlike most other forms of consumer credit, the interest rates charged to students on FFELP loans are set by law, so lenders are not able to recoup these additional costs on the FFELP loans that they originate.

As a result, only $8.4 billion of student loan ABS was issued in the first quarter of 2008. That number compares to $21.7 billion issued in the first quarter of 2007. That is a very dramatic change year over year.

Put simply, originating new FFELP student loans has largely become an unworkable business model for many of America's lenders. This unworkability has already demonstrated dramatic consequences recently. Approximately 50 lenders have already exited the FFELP program altogether or suspended lending, which represents nearly $8 billion, or 15 percent of 2007 originations.

But still looming over the next couple of months are the decisions to whether the other lenders will continue to originate under the FFELP program, and if so, what origination reductions they will be forced to implement if they do continue their participation in the program. Ultimately, the effect of last year's significant incentive reductions, plus the current high cost of credit in the capital markets, plus the inability to recoup these loans have sunk into a growing concern of severe disruption in the availability of students through the FFELP program.

So today, we propose two potential short-term solutions that we believe appropriately balance Federal Government risk exposure and involvement with meeting the urgent need for additional sources of liquidity to help fund the student loan originations.

First, the Federal Financing Bank at Department of the Treasury already has the statutory authority to provide additional liquidity to lenders to originate new FFELP loans.

Second, the definition of program eligible collateral of the newly created Term Securities Lending Facility could be extended to include AAA-rated student loan ABS, which would allow these securities to be pledged as collateral to borrow from the new lending facility.

Chairman Dodd, we applaud your correspondence to Secretary Paulson and to Chairman Bernanke on each of these subjects and encourage the Federal Government to act expeditiously to implement a targeted and near-term response that mirrors existing market practice and does not expose the American taxpayer to any additional credit risks. We believe these actions would help a much greater and potentially more costly Federal intervention later.

I thank you, Mr. Chairman, for the opportunity to testify on this important and timely issue today and we look forward to working with the committee, the administration, and with regulators to ensure student loans are available to all eligible borrowers who seek financing for their educational expenses. Thank you.

Chairman DODD. Thank you very much, Mr. Deutsch.

Ms. McGuire, thank you again for being with us.

STATEMENT OF PATRICIA McGUIRE, PRESIDENT, TRINITY WASHINGTON UNIVERSITY

Ms. MCGUIRE. Thank you so much, Senator Dodd. It is a tremendous honor to be here today on this important topic, and I am here,

as well—I, too, am a financial aid baby and I would not be sitting here today but for the Federal loans that supported my education, also. So I personally appreciate this.

Trinity, of course, is proud to be the alma mater of the great Dodd women, Grace and Martha, and such pioneering women as Senator—Speaker Pelosi—I just promoted her—Speaker Pelosi and former Connecticut Congresswoman Barbara Kennelly, as well, your former colleague in the delegation, and Kansas Governor Kathleen Sebelius. So we have a great track record here.

Trinity has changed quite a bit since the days when those great women and I was a student at Trinity and I am really here today to put a face on this potential crisis for students of a different variety than most people think of when they think of private colleges today.

Trinity and our students are at grave risk in this current crisis, make no doubt about it. Trinity's $10 million endowment—$10 million—marks us as one of those colleges founded by nuns whose devotion to mission led them to spend more time teaching than amassing wealth. One of the great ironies of contemporary higher education is that small, marginally resourced private institutions like Trinity now serve proportionately more low-income students than many public universities, particularly the flagship State universities.

Trinity's median family income today is about $30,000, compared to median family income near $100,000 at the University of Maryland-College Park or the University of Virginia. Sixty-two percent of Trinity students today receive Pell Grants, a strong indicator of the critical economic challenges our students face. Nearly 90 percent of Trinity's students today are African-American and Latina, and more than 95 percent are low-income students receiving large amounts of aid.

Trinity enrolls more District of Columbia residents than any other private university in the nation. Indeed, about half of our students are D.C. residents. We have great success with these students. Sixty-five percent of the students from the District of Columbia over the last 5 years are either still enrolled or have graduated, and this is a tremendous record in a city where only 9 percent of today's ninth graders will likely graduate from college. Nearly 100 percent of our graduates are employed by the time of graduation due to our strong internships, including many here on the Hill. And many of our graduates go on to distinguished graduate schools, including recent acceptances to Columbia, Penn, Cornell, Georgetown, and UVA.

Trinity's $18,250 tuition price tag is much lower than the area private universities that Senator Dodd mentioned earlier, and we provide nearly all of our full-time students with unfunded institutional grants averaging 40 percent of that tuition price tag. Unfunded means we don't have any cash backing up that discount.

To pay the tuition balance after the large grant and their Pell Grants and other grants, our students depend heavily on Federal student loans and some private loans. Not many—many of our students can't get private loans, but they get the Federal student loans.

Unlike students from wealthier families, my students have no fallback position. Yale, Harvard, Princeton, we have read about them, other immensely wealthy institutions. They can relieve middle-class families of any worries by removing loans entirely from their financial aid mix using the earnings of those massive endowments to subsidize students whose family incomes may be as high as $150,000 a year. My students, whose families would be delighted to earn $50,000 a year, cannot have the same financial privileges or comfort.

Where will my students go if their loans disappear? What will Trinity do if our students cannot afford to pay their modest balances on their tuition bills? The credit crisis poses enormous risk for students and colleges both.

Our students at Trinity clearly need the Federal loan program to help them cover the remaining tuition costs that Trinity and other grants cannot subsidize, as well as the additional costs of attendance beyond tuition, including support for housing, food, and books and transportation. Books today alone can cost $150 a pop for some of the courses.

Our experience shows that we refund about 35 percent of the $13 million our students borrow back to the students, and the refunds make it possible for the students to pay for those books and their housing and food costs.

To understand the significance of the federally guaranteed loan programs, in my testimony today, you will see a snapshot of our total financial aid volume in 2007–2008. This year, 1,300 Trinity students received $13.6 million in Federal loans, and 80 students received another $800,000 in private loans. You will see a chart in my testimony to see how the loan volume is distributed across grade levels, on average. Of course, graduate students receive the largest loans because they have the highest thresholds.

For the nearly 1,300 students receiving loans, any reduction in their ability to borrow could be catastrophic. Graduate students borrow up to $18,000 a year or more because they are not eligible for grants, so they use the loans to support their tuition price as well as living. Three-hundred-and-seventy-two students enrolled in our first year received $5,555 in loan support with other aid sources. Trinity provides those same students an average Trinity grant of $6,500 on top of the $5,500 loan, and 78 percent of that first-year group also received Pell Grants averaging $3,400. Those first-year students in particular at age 17, 18, 19, and 20 could not possibly replace the $5,500 in loans from any other sources and Trinity cannot possibly give more than the 40 percent discount we are already giving on our tuition price.

I should point out that with the very large loan volume that Trinity has, our default rate is just 3.2 percent. Our students are very serious about their collegiate educations and they well understand the obligation to pay back these loans, and that is a great tribute to them.

While the vast majority of Trinity students participate in the FFELP program, a small number also receive private loans. We have 81 students, including 78 undergraduates, who received nearly a total of $800,000 in private loans. This group is the most seri-

ously at-risk group if the private loan market collapses and we could not possibly backstop that loss.

To put all these numbers in perspective, Trinity's $25 million operating budget is 80 percent dependent on student tuition and fees. We are lucky to have many generous benefactors who also give us charitable gifts. That is about 10 percent of our budget. Because student loans are the largest form of financial support our students receive, any weakness in their ability to secure loans will also impact Trinity's bottom line quite severely. Our $10 million endowment could not possibly backstop any erosion in student loans.

Federal student loans are essential to fulfilling the promise of higher education for the students we serve at Trinity who are not so very different from millions of American college students except they do represent the new generations of new populations coming into American higher education in great number. The return these students make to this nation is incalculable. Trinity's great past is just a prophecy of the great future we will have and contribute to our nation. Any interruption of student loans will be a great loss not only for our students and our institutions, but for the Nation they will continue to lead in the future.

Thank you so much, Senator Dodd, for your initiative on this very important topic.

Chairman DODD. That is wonderful testimony, Ms. McGuire. We thank you immensely for it.

Ms. MCGUIRE. Thank you, Senator Dodd.

Chairman DODD. Sarah, welcome back.

STATEMENT OF SARAH FLANAGAN, VICE PRESIDENT FOR POLICY DEVELOPMENT, NATIONAL ASSOCIATION OF INDEPENDENT COLLEGES AND UNIVERSITIES

Ms. FLANAGAN. Thank you. Mr. Chairman and members of the Banking Committee, thank you for holding this important hearing today. NAICU represents 953 of America's private colleges, from the Ivy League, to women's colleges, to Historically Black Colleges, to a myriad of faith-based institutions that represent the full diversity of our nation's people, history, and collective intellectual traditions.

I am proud to share this panel today with Pat McGuire, not only because I so admire her and her institution, but because Trinity is the perfect example of the type of school we represent.

When they first hear the term "private college," Americans often think of the Ivy League schools, schools that, by the way, give great student aid packages. However, Trinity is much more typical of our nation's 1,600 private colleges in wealth, purpose, and in size, and your 40 percent figure struck me because that is the national average for private colleges after grants. The average tuition support is 40 percent in private colleges.

Also defying conventional wisdom, many families find that when their aid offer arrives from private colleges, the actual price they will pay is comparable to the cost of a public college. This is because of the huge amount of grant aid our colleges provide from their own funds.

Still, not all colleges can make up the difference in cost for everyone. Some students are unable to cover all expenses through the

Federal Student Loan Programs, since these programs have strict borrowing caps. The net effect has been a burgeoning private student loan market. For the most part, students at NAICU colleges are relying on these loans as a last resort, a limited and imperfect but essential access tool for some students.

Between March 3 through 14 of this year, we decided to survey our members to determine how the turbulence in the auction rate securities market was affecting student loans. A copy of our survey and details of our findings are attached to my testimony. In general, some lenders are leaving the program and schools are in a regular scramble to find replacements. But we were relieved to find that schools are still able to secure new lenders. Colleges and the students we serve are not in crisis.

Both Federal and private loans have seen a reduction in borrower benefits. In private-label loans, we are seeing the imposition of new credit requirements, requirements that may have been nonexistent just last year. Tightening credit requirements is not all bad, particularly if an institution's default rate on Federal loans gives evidence that students may not be able to handle the additional debt. But losing supplemental loans funding for all students at all colleges could pose an insurmountable barrier for many. One of the findings that both surprised and concerned us was that 60 percent of the colleges that use private loans indicated they were essential to their institution's overall financial health.

Since we closed this survey, storm clouds have continued to gather. One State did a follow-up survey with its members to see if students could meet the new private loan credit requirements. The news was not good, leading several colleges to be fearful of their own financial stability and nearly every college expecting to lose some students if alternatives cannot be found.

This month begins a critical time in student lending. High school seniors only have between now and May 1, when deposits are due, to make their final choice of the college they will attend. As we sit here today, families across the Nation are sitting down comparing options and making these tough choices, factoring in the types and amounts of student loans they have been offered by the various schools. From May until late August, the loan process will be in high gear. Many of our institutions are anxious that the financing markets might worsen in the middle of this peak processing season.

Adding to colleges' worries are problems many of them are facing in refinancing their own institutional bond debt or the increased cost of that debt, and I want to emphasize that. Colleges' bond debts are also in this market that has—and they also are having failed markets on their own debt. We have done a small survey on that and we are getting reports of institutions where just the increased cost on that bond debt is a couple of hundred thousand dollars a month.

Wisely used, student loans are good loans, and not just because of the return on such an investment that we realize as a nation. Student loans are also a good financial investment for lenders. This is nothing short of amazing, and in fact, it is counterintuitive. Traditional students come to college with little or no credit history. Those that need to borrow the most are the poorest. In purely eco-

nomic terms, this sounds like another high-risk portfolio. However, the numbers show the opposite true. Private colleges and universities have a default rate in the Federal Student Loan Programs of 2.4 percent. That is a proud record for a program in which the collateral is simply an improved mind, not a car or a boat or a home that can be reclaimed and resold.

We realize the huge challenges this committee faces as you work to protect our economy from a crisis in the housing market. However, we also ask you to remember the nation's home of our minds, the enterprises that drive our knowledge-based economy, our colleges and the students they serve.

We were asked to bring ideas to you today on how to avoid a student loan problem. At the risk of sounding naive amidst a panel of financing experts, I offer one simple inexpensive and quick step this committee might take. Please encourage Education Secretary Spellings and Treasury Secretary Paulson to make a joint statement to the American people that they will stand by America's students and the loan programs. That type of assurance in and of itself could send an important signal to investors that this is safe paper and ones they should invest in. Ultimately, this is not about the lenders. This is about the students. Let us give them a simple assurance that their educations matter to us all.

Chairman DODD. Very, very good, Sarah. Thank you very much. We appreciate it.

Mark.

STATEMENT OF MARK KANTROWITZ, PUBLISHER, FINAID.ORG

Mr. KANTROWITZ. Thank you, Chairman Dodd, Ranking Member Shelby, and the distinguished members of the Senate Committee on Banking, Housing, and Urban Affairs for convening this hearing and for the opportunity to appear before you. I am Mark Kantrowitz, Publisher of FinAid.org and Director of Advanced Projects for FastWeb.com. FinAid is the most popular website for student financial aid information, advice, and tools. FastWeb is the largest free scholarship matching service.

Contagion from the subprime mortgage credit crisis has infected the education loan marketplace. There have been no successful bond issues for State loan agencies and no securitizations of private student loans since last fall. While there have been some securitizations of Federal guaranteed student loans, the volume is down by more than 57 percent year over year, and the cost of funds has increased by 137 basis points, on average. None of these securitizations have involved federally guaranteed student loans originated since October 1 of 2007. The auction rate securitization market is dead. These problems are occurring despite the AAA rating of the student loan securities.

The lack of liquidity has led to an unprecedented exodus of education lenders from Federal and private student loans. As of today, 57 education lenders have suspended their participation in federally guaranteed student loans and 19 lenders have suspended their private student loan programs.

In fiscal year 2006, these lenders originated more than $6.5 billion in Stafford and PLUS loans to more than 800,000 borrowers and more than $48.5 billion in consolidation loans to more than 1.6

million borrowers. That represents 13 percent of Stafford and PLUS loan volume and 67 percent, two-thirds of consolidation loan volume. These lenders include 21 of the top 100 originators of Federal Stafford and PLUS loans and 27 of the top 100 originators of Federal consolidation loans. The top 100 lenders originate 91.5 percent of Stafford and PLUS loans and 99.8 percent of consolidation loans.

Last week, Sallie Mae, the largest education lender, announced it will no longer make consolidation loans. The Education Resources Institute, otherwise known as TERI, the largest nonprofit guarantor of private student loans, filed for Chapter 11 bankruptcy. Nelnet sold $1.2 billion worth of student loans for an after-tax loss of $28 million. There have been more than 2,500 layoffs industry-wide.

The credit crisis has also had a direct impact on borrower eligibility for Federal and private student loans. Borrowers with a foreclosure, as you noted, in the last 5 years are ineligible for the Federal PLUS loan. I believe there will be about a 10-percent increase in PLUS loan denials at the start of the 2008–2009 student loan season, maybe more.

Lenders are also tightening credit underwriting criteria for private student loans. Credit score requirements are increasing from a FICO score of 620 to at least a 650—anything under a 650 is considered subprime—and approval rates have dropped by 10 percent to 25 percent. Overall, more than 100,000 additional families will be ineligible for both the Federal PLUS loan and for private student loans.

The cost of Federal and private student loans has also increased. Most lenders have cut their Stafford and PLUS loan discounts in half and have eliminated discounts on consolidation loans. More than a dozen private student loan lenders have increased the interest rates by an average of seven-eights of a percent on their student loans, more on borrowers with bad or marginal credit than on those with good credit.

These are signs of a very serious threat to our nation's education financing system and cause for concern. Without loans, some students may be forced to drop out of college.

Existing solutions are inadequate. Neither the Direct Loan Program nor the lender of last resort program has been tested under the extreme conditions we face today. For example, the Federal Direct Consolidation Loan Program's volume will be more than four times last year's volume and more than twice the previous peak volume. Neither program addresses the liquidity problems that are forcing education lenders to exit the marketplace. Both are reactive solutions that offer the potential for a significant disruption during any transition or implementation period.

It is better to implement proactive solutions that prevent a crisis. The most effective solutions will involve injecting liquidity into the student loan system. Three possible approaches include allowing the Federal Home Loan Bank and the Federal Financing Bank to invest in highly rated student loan securities, allowing lenders to pledge highly rated student loan securities as collateral for the Federal Term Securities Lending Facility, and conducting a reverse student loan auction in which lenders would compete for U.S.

Treasury investment in highly rated student loan securities. The third approach would set margins competitively and is of limited duration, minimizing the need to wean lenders off of a source of cheap capital.

Other proposed solutions are aimed at restoring investor confidence. These include stand-by loan purchase agreements, government insurance of bonds and securitizations against lender default, and eliminating the index rate mismatch. With regard to the latter, currently, Federal education lenders receive income that is indexed to the 3-month commercial paper rate while their cost of funds is indexed to the LIBOR index. Eliminating this index rate mismatch by changing from the commercial paper rate to a revenue-neutral margin relative to the LIBOR index would yield more predictable spreads and would simplify the structure of student loan asset-backed securitizations by avoiding the need for interest rate swaps. These solutions would reassure investors by reducing some of the risks associated with investing in these instruments.

Chairman Dodd and Ranking Member Shelby, I once again thank you and the committee for taking an interest in ensuring the continued availability of education loans and for inviting me to share my thoughts on the matter. I would be happy to answer any questions you may have.

Chairman DODD. Well, thank you very, very much, Mark. That is very worthwhile testimony. I want to commend all of you for very thoughtful testimony this morning and some very good suggestions.

Sarah Flanagan said something in her testimony that I presume to all of you may have jumped off the page at you. It certainly did to me, and one that I would like to rest of you to comment on as you look at it. Again, the backdrop of which you are all familiar with, obviously the credit crunch and liquidity crisis affecting capital markets is obviously spreading. We are all aware of that knowledge of it and what it could mean in terms of the possibility of, one, students not getting loans. That is one concern, obviously. Then if they get loans and these numbers begin to change, then whether or not they can stay in school, obviously a significant problem and not an insignificant one even today under normal, relatively normal circumstances.

But Sarah said the following. She said, nearly every college expects to lose some students—I presume in addition to the ones you are already losing—if something isn't done to ensure supplemental loan funding for students with the greatest financial need, and I would like to know from the other members here whether or not you agree with her, that unless conditions significantly change or there is action by the government, that some students may not have the financing they need to attend college as a result of the ongoing crisis in our capital markets. And short of no access to credit, how many students will be negatively impacted through increased costs of borrowing.

If you could respond to that, I would be very interested. Why don't we begin with you, Jack?

Mr. REMONDI. Sure. Thank you, Senator. Clearly, from our perspective, we know that a student who graduates is the best student that we could have from a credit quality perspective. We have

heard some mentions of FICO scores here this morning, but FICO scores are perhaps an early indication of someone's creditworthiness, but when you are lending to a college student, it is all about graduation rates. It is an investment in their education and by obtaining that degree, they get access to better-paying jobs and higher levels of employment, or lower levels of unemployment.

So from our perspective, we do everything possible to make sure that once we fund a student in the private credit market, that we are working to make sure that they have access to loans to complete their degree. If we don't allow them to do that or we deny that subsequent loan, we are only creating a future problem for ourselves.

Chairman DODD. Yes.

Mr. REMONDI. Now, the problem, of course, though, is we can only lend to the extent of what we can borrow ourselves in the capital markets and the situation as it is presenting itself today is one where our access to funding is severely limited. You have heard from the testimony this morning that there are no private credit loans. No private credit loan asset-backed transactions have been completed this year. The last one was last fall, in 2007. We at Sallie Mae do have other sources of funding that we had issued in prior years that we can make available to private credit lending and we plan to do so. That access or availability of those funds, however, is dependent on our ability to be able to refinance the Federal student loans that are presently being financed by those sources of funding.

Chairman DODD. Yes.

Mr. REMONDI. And so if we have access to things like the Federal Financing Bank or the access to the Federal student loan term asset-backed market opens up, it does free up private credit capacity for us.

Chairman DODD. I am going to come back, because you and Mark are both advocating that the Federal Financing Bank inject liquidity into the market, so I want to come back in a minute after you have answered this question and ask the other panelists to comment on that suggestion, as well. I think it is a very intriguing one and one that I am very much interested in. It is a little different. Congressman Kanjorski, for whom I have a lot of respect on the House side and has spent a lot of time on these issues and very knowledgeable about them, has a different approach on this and I would like you to sort of educate the committee, if you would a bit, on those two different ideas and why you think the one that both of you are suggesting is the better way to go.

But in the meantime, let us come back to the question I asked about Sarah Flanagan's comments.

Mr. DEUTSCH. Well, at least from the ASF perspective, I think our view is that if you have a significant withdrawal of lenders being able to lend, if there is a significant amount of capital, even we have already seen 15 percent of originations from 2007 which are off of the market, and I think you will see significant additions to that over the next month to 2 months, if you take that much capital out of the system and students don't have access to that capital, the ultimate question is are they going to be able to afford their education.

And I think as Mr. Remondi indicated, it may fall on the incoming freshmen, I think is the most affected class, because lenders obviously have an incentive for those that they have lended to already to keep those students in college. But I think for those new students going to college, I think from all the discussion, I think those are the ones that are going to be most affected this fall.

Chairman DODD. Let me interrupt your own question that I have asked you because one of you said, and I forget which one of you said this—this may have been you, Sarah—that this problem could occur, really could peak at the worst possible time. We are now in April and obviously this process is beginning. By holding a hearing on the subject matter in April, people are saying, why aren't you doing it in September? Well, because this is the process when people really begin to apply for this.

But you could have the problem really peak this summer at some point, and I know there are those who are advocating—and I am an advocate. The old idea of direct loans is something—I think is something that institutions ought to have the right to consider and want to use. Others are a little more aggressive about the Direct Loan Program. But I am told that the process of direct loans, even if they are up and going, is somewhere between four and 6 weeks—I want you to correct me if I am wrong on these numbers—and so even if that is a potential option later in the year, it might not work out given the time constraints when students begin school and to get that financial assistance. If I am off on anything I have said there, I would like you to comment on this.

Tom, do you know? Do you have any comment on that?

Mr. DEUTSCH. I think I might defer to the colleagues from the school, but I would emphasize, I think the urgency of this from a lender's perspective, I think what you have seen so far over the last month to 2 months with a number of lenders announcing right now that they are not able——

Chairman DODD. Do you expect those numbers to grow, by the way?

Mr. DEUTSCH. I expect those to grow substantially.

Chairman DODD. Fifteen percent to what? Any idea beyond the 15 percent?

Mr. DEUTSCH. I think it would be speculation for me to make any kind of percentage targets, but I think it will grow—it will continue to grow substantially.

Chairman DODD. Mark, do you have an idea?

Mr. KANTROWITZ [Off microphone]. Well, if there is no government intervention—I think there would be only 15 to 25 left because most of the lenders who are out there depend on the top 100. Ninety-one-point-five percent of Stafford PLUS originations came from the top 100 educational lenders, so beyond the top 100, it doesn't really matter. And the difference between the 13 percent figure that I have been giving and the 16 percent figure that Jack Remondi mentioned is the school's lender schools. Most of them have been informed that their lender partners will no longer be funding their loans and that is likely to disappear. They are still having admitted that they are not being able to make the loans, but they won't be able to.

Chairman DODD. I have listened to everything you just said. Give me a number here that gives me a——

Mr. KANTROWITZ. It is 15 to 25 lenders from 2,700. I haven't totaled how much it is, but probably about half of all loan volume is at risk of significant disruption.

Chairman DODD. Half of all——

Mr. KANTROWITZ. Federal and private loan volume.

Chairman DODD. So the $90 billion, we are looking potentially at something that would put $45 to $50 billion at risk?

Mr. KANTROWITZ. Yes.

Chairman DODD. I want to go back to the other question.

Ms. MCGUIRE. Will we lose students?

Chairman DODD. Yes.

Ms. MCGUIRE. Absolutely. And in fact, the kind of students we have at Trinity are exactly the kind of students who are more likely to have to stop college. When we look at our attrition rates every semester, the single greatest reason why students have to stop out from their college education is financial for the low-income students we serve. If there is any interruption of their ability to borrow at the way they are borrowing right now, it could be devastating.

I do want to comment on this is, in fact, the moment of the largest surge of students going to college that we have seen since the baby boom, and at Trinity, not to put too fine a point on it, as one of the historic Catholic women's colleges, for years, we suffered a great enrollment decline. Now we are about to welcome the largest freshman class we have seen since about 1967 and we see hundreds and hundreds of young women, but they are very different young women from the past. These are, as I mentioned earlier, predominately low-income women of color from the city.

There has been a tremendous push in the District of Columbia to get our local residents into college, and when I see—just last weekend, we had Prospective Students Day—literally hundreds of students so eager to come from our local public high schools to Trinity, where we do a great job with them, and then I think that come June, July, August, when they are trying to put their packages together, that there might be some retrenchment on the credit available to them, on the loans available to make this dream a reality. It really makes me kind of sick, actually, to think about that. It is potentially a terrible crisis.

I look at the loan volume that our students in the upper-class years. I know the lenders are saying they will mostly focus on keeping students in school who are already there, and yet those students, too, are so marginal. Ultimately, the greatest impact of this crisis will be on the lowest-income students who need this support the most.

I hear lenders talking about maybe looking at students who are at risk of dropping out or that sort of thing. I think we really need to be very careful about ensuring that whatever tactics are used to address this problem, that it does not leave out the students who need this kind of support the most.

Chairman DODD. Yes. Sarah, you made the comment, so I know your views on this. I want to quickly, because I have gone over my time already, I want to come back to the very idea and suggestion that both Mr. Remondi and Mr. Kantrowitz are proposing, and that

is using the Federal Financing Bank to inject liquidity into the market. Specifically, I want to know whether the FFB can and should do direct purchasing, in which case the bank cannot inject more than $15 billion in liquidity under existing regulations, I guess, or statutes, or whether the FFB should lend to the Treasury Department or some other Federal agency to allow that agency to use those funds to inject liquidity into the market. And then, of course, there has been a different suggestion by Congressman Kanjorski.

Do you have any comments on this, any of you, the three in the middle?

Mr. REMONDI. Sure. We believe the Federal Financing Bank does provide the simplest and fastest solution to this problem, because it doesn't require legislation and its authority to invest in government-guaranteed assets already exists. We also think it is critical to the process that the loans that need to be originated this upcoming academic year need to be processed through the infrastructure that exists today. Because we are at April 15 and the peak lending season begins in the next several weeks, there is really no opportunity to redirect that volume to other sources. And 80 percent of loans that get originated this academic year do get originated through the Federal Student Loan Program—through the private sector version of the Federal Student Loan Program.

Other options that are on the table, like the Federal Home Loan Banks, are something that we would also support. The problem, it is all of these things together. Probably no one solution is the single solution for the entirety of the issue. It is more a combination of solutions to address the problem, and the Federal Home Loan Bank advances would be helpful to that.

Chairman DODD. Yes.

Mr. REMONDI. One thing to note, however, is about 80 percent of the loans made under the Federal loan programs are made by nondepository institutions, so we are institutions that do not have access to the Federal Reserve and do not have access to the Federal Home Loan Bank, so we would be dependent upon others to assist in that process, which is why we recommend the Federal Financing Bank as the best solution.

Chairman DODD. Mark, do you want to add to this in any way?

Mr. KANTROWITZ. I think they covered it very well. I would like——

Chairman DODD. Is that microphone working?

Mr. KANTROWITZ. I point out that there has already been one school closure that is attributed to the student loan credit crisis. Silver State Helicopters of Nevada blames the credit crisis for its failure, and that school is closed, leaving a lot of students who had borrowed from private student loans with no education and high debt.

Chairman DODD. Thank you. Any comments, Sarah and Ms. McGuire on this?

[No response.]

Chairman DODD. OK, thank you. Senator Shelby.

Senator SHELBY. Mr. Deutsch, it appears that investors are lumping all structured debt products together, including guaran-

teed student loans, and are generally avoiding these products. Is that true?

Mr. DEUTSCH. I wouldn't necessarily say that they are lumping them all together. I think what——

Senator SHELBY. What are they doing?

Mr. DEUTSCH. What is happened is that investors—the supply of capital in total has shrunk, so it is not necessarily that, say, for example, FFELP student loans, that they ascribe any higher credit risk to them than other credit products. It is that there is simply much less supply of capital out of the market and obviously a lot of demand by the different issuers, whether it is student loans, credit cards, mortgages, automobiles.

Senator SHELBY. Do you securitize the student loans like you do a lot of other things?

Mr. DEUTSCH. It is a very—it is the exact same process as——

Senator SHELBY. What is the credit risk here? We know there is great credit risk in subprime. We know the track record there.

Mr. DEUTSCH. Sure.

Senator SHELBY. A lot of people should have known it ahead of time, but I haven't heard of a lot of securities that have been bought, structured, and so forth defaulting. Can you get into that?

Mr. DEUTSCH. Sure. I think in the student loan asset-backed base, there is, especially in the FFELP-backed, asset-backed securities, very little——

Senator SHELBY. What do you mean by that, for the record?

Mr. DEUTSCH. A FFELP—if you originate a FFELP student loan, it comes with a principal and interest guarantee from the government of, say, 97 percent. So if that student would default on that underlying student loan, the Federal Government would step in.

Senator SHELBY. You have got a guarantee there.

Mr. DEUTSCH. Exactly. So when you package those into a securitization, the underlying credit risk of that collateral, those student loans effectively is very minimal. So it is surprising that when you look at the student loan asset-backed securities market that the spreads have widened quite significantly. And again, I would go back to the point that it is not investors ascribing a higher credit risk to that underlying collateral, but just simply their ability to demand higher spreads because there is so much demand for capital out in the market right now but so little supply from investors generally.

Senator SHELBY. But there is a lot of cash in the market everywhere, you read. This is just spread from the subprime and other markets and people are nervous about investing, is that it?

Mr. DEUTSCH. I believe there is a significant concern about credit and extending credit in America right now across any type of asset.

Senator SHELBY. And notwithstanding these are quality securities?

Mr. DEUTSCH. But the student loan asset-backed securities are AAA rating. Very few, if any, have ever been downgraded.

Senator SHELBY. Mr. Remondi, how do you access credit, just for the record? You are the Chief Financial Officer at Sallie Mae and you go to the market. You have to have money. Just briefly explain how you do that.

Mr. REMONDI. We rely principally on the securitization market. So we bundle loans into securities and then sell principally in the term asset-backed market. We have never relied on any significant degree in the auction rate securities market.

If I may expand on my colleague's comments, the investors at this stage in the game are fearful for lots of reasons. Certainly, there has been a tightening of the supply of capital to invest and some of that is not that cash is less available, it is just not available for term investments. So everyone is being very cautious and conservative.

But in addition——

Senator SHELBY. What is money costing you right now, roughly?

Mr. REMONDI. Well, right now, our last transaction which we priced last Friday, so this is very new, was LIBOR-plus-143 basis points, and that is up from LIBOR-plus——

Senator SHELBY. LIBOR is adjusted every 3 months, or what?

Mr. REMONDI. LIBOR is adjusted——

Senator SHELBY. It is a 3-month rate.

Mr. REMONDI. Correct. That is correct. And we look at it as a spread differential because our underlying assets are variable rate, as well. So the assets and liabilities move with interest rates in general——

Senator SHELBY. What would that be above Treasury?

Mr. REMONDI. Above Treasury, that would be about 260 basis points.

Senator SHELBY. OK. So you are paying more.

Mr. REMONDI. We are definitely——

Senator SHELBY. People get a better return and very few defaults, right?

Mr. REMONDI. That is right. Investors are not concerned about the quality, the credit quality. They are concerned about the market price risk in the asset itself.

Senator SHELBY. Ms. Flanagan and President McGuire, efficiency in Federal lending. Ms. Flanagan, in your testimony, you stated that current legislative efforts to address potential liquidity problems include providing modest increases in the Federal Student Loan Program. If there are no lenders to supply the loans to schools, then students may be forced to go out to the private student lending market and skip subsidized Federal loans altogether.

Do you believe that the Federal Family Education Loans provided by private lenders have helped achieve efficiency both for institutions of higher education as well as borrowers?

Ms. FLANAGAN. Absolutely. It is a wonderful program. It has got a tremendous history. When the Federal Government really got into the program and set it up in 1965, it did so because everybody's image was that who would lend to a 17-year-old.

Senator SHELBY. OK. If that is so, which you say it is, doesn't it make sense, or does it make sense to take steps to ensure that these lenders are available to administer this program if they are efficient?

Ms. FLANAGAN. Yes.

Senator SHELBY. Do you agree with that, President McGuire?

Ms. MCGUIRE. Yes, absolutely.

Senator SHELBY. Efficiency is very important in the market, isn't it?

Ms. MCGUIRE. I totally agree with that, yes.

Senator SHELBY. OK. Thank you, Mr. Chairman.

Chairman DODD. Thank you very much, Senator Shelby.

Before I turn to Senator Reed, let me, because I want to pick up on the point Senator Shelby made. I think it is a very important point and one that, Jack, you emphasized, as well. Fed Governor Kevin Warsh shares the very point I think that Senator Shelby was making and that you made, Jack, as well. I just wanted to quote him here. He spoke yesterday at a speech in New York.

He said, "Credit quality concerns alone do not appear even now sufficiently widespread to induce the depth of problems witnessed in financial markets during the past several months. Some auction rate securities that failed, for example, funded pools of federally guaranteed student loans." And so the quality is really not the issue.

And again, I come back to the point, and I don't know if you agree with it, but the epicenter of all of this is this foreclosure issue. That is where the center of all of this is spreading out. And the headline this morning, I think, in one of the leading newspapers is all about consumers and stores failing because of the spread of this problem into what is occurring. So I just make that point. I think it is a very valid point and sometimes gets lost in all of this.

Senator Reed.

Senator REED. Thank you, Mr. Chairman. I thought the line of questioning by Senator Shelby was directly on target. I think what both Mr. Remondi and Mr. Deutsch said is that there has been a dramatic replacing of credit risk but no significant change in credit risk, and it is a result of extraneous issues, the overall situation in the market. It raises a couple of questions or a couple of comments.

This would not result from the change we made last year in the higher education legislation by lowering the subsidy rate to lenders if, in fact, the overall credit markets were performing, is that a fair judgment? Mr. Remondi?

Mr. REMONDI. Yes, I do believe so. I mean, at the time the rates were cut, funding costs were at LIBOR-plus-ten, so it did impact materially the margin of profitability that lenders made in the Federal loan program. But the access today would not be an issue if those conditions continued to exist.

Senator REED. And do you agree, Mr. Deutsch?

Mr. DEUTSCH. Generally, I agree, as well.

Senator REED. Thank you. The other issue, and again, this will reveal my ignorance rather than my knowledge of these systems. The Federal Reserve has been cutting interest rates with great energy over the last several months, yet this has not yet translated into something very palpable, like student loans that are affordable, is that accurate, and do you have a reason why that is happening, Mr. Remondi?

Mr. REMONDI. The interest rate on Federal student loans is fixed and set by Congress, so the——

Senator REED. Well——

Mr. REMONDI [continuing]. For the life of the loan, so as rates come down——

Senator REED. Let me rephrase that. There is an interest rate environment in which interest rates of financial institutions are being reduced dramatically by the Federal Reserve, and yet you are looking at LIBOR-plus-140 basis points. There seems to be no correlation between Federal Reserve action and what your borrowing costs. Can you——

Mr. REMONDI. That is—I mean, the index on which our borrowing costs is based has been falling, but the spread that we pay as a credit risk factor on top of that has been rising. So LIBOR is generally set as a risk—as kind of a risk-less kind of spread and the rate investors are demanding above that has expanded 14, 15 times, as we have heard.

Senator REED. I think one of the proposals that Senator Dodd was asking about and you seemed to think is useful is opening up the Federal Financing Bank. How should that credit physically be priced? If you are paying LIBOR-plus-140, how should the Fed price it so that we don't have a situation where we are reinstituting significant subsidies to you?

Mr. REMONDI. That is right. The Federal Financing Bank typically lends to various government agencies at Treasury bills plus one-eighth to three-eighths of a spread. We have proposed an interest rate in the Federal Financing Bank proposal that we have set forth, that that rate be set at commercial paper plus 40 basis points. That would be higher than the historical rates that we have paid to finance in the securitization markets in the past, but certainly it is a number and it is a number that is open to negotiation, obviously.

Senator REED. Mr. Deutsch, do you have any comments on the pricing issue?

Mr. DEUTSCH. I would say that it is critical that originating lenders get access to funding that is at a price that they can sustain a business model of originating loans, and I think what you have seen right now is that it is simply unsustainable pricing that they are getting from the secondary market. So I don't have a specific opinion at this point on the exact price that it should be at, but I think that should be the benchmark that should be established.

Senator REED. Mr. Kantrowitz, do you have any comments on this whole line of questioning?

Mr. KANTROWITZ. Well, one benefit of a reverse student loan auction is that it would set the costs of capital competitively, so let the lenders bid commercial paper rate plus whatever they are willing to bear in order to get the liquidity.

Senator REED. Thank you. I notice, Ms. Flanagan, that the American Council of Education indicates that one in five borrowers pass up less expensive Federal student loans. Half do not even bother to file the paperwork necessary to qualify. For both President McGuire and Ms. Flanagan, if you have 20 percent of your students that are going to the higher-priced option right out of the box, is something wrong with counseling, financial aid advisors, something wrong with the way the marketing—can you give us any——

Ms. FLANAGAN. There could be. I have seen that study and there are—we don't know at one level, but there are other reasons why people may not have exhausted all of their Federal borrowing before they are in the private market.

One reason is that there are some places in this—48 percent—this is another fact about private colleges—48 percent—that will surprise people—48 percent of private undergraduates are first-generation in college, meaning that neither of their parents got a Bachelor's degree. A lot of those families classically will not even apply for a PLUS. I mean, you are 18 years old. You are on your own. Figure it out. You want to go to college? Maybe that is OK. We are from the same State. That is not OK for some of the ethnic groups. They want the kids to go right to work, and if they want to go to college, they are on their own. So I think that that is a factor here that doesn't show up in some of that data.

Senator REED. President McGuire, there seems to be—if this is the case, this study suggests 20 percent, what does that say about the counseling, the advice you are giving? I have dealt with financial aid officers in my home State of Rhode Island. They are remarkable. I mean, they go beyond to make sure that their students have the resources to stay in school. But is there something more that can be done, should be done?

Ms. MCGUIRE. Well, first of all, let me say that statistic may be true for some national cohort, but it is not true for Trinity. We have a very small number of students who are even eligible for private loans, let alone taking them.

I think financial aid directors and staff work incredibly hard in one of the most complicated environments for any financial advisors anywhere. These packages have so many different elements to them.

It is true, however, and it is even true with my students that families often are not financially as well-versed as we all wish they were. I find with the students we serve that there is a great deal of reluctance on the part of parents, the students Sarah just described, where if a young lady wants to go to Trinity or some other institution, she may be told by her parent, usually one parent, that she is on her own. She has to figure it out on her own. And frequently, the families will not cooperate even in sharing the tax records of the family or other sorts of information the student needs. Therefore, sometimes the student can get lost in the system if we don't pay very careful attention and she may wind up having not a good deal. She may have some uncle advising her to do the wrong thing.

I think most financial aid officers try to get the best deal for their students all the time and I would like to know more from ACE, where the 20 percent really is.

Ms. FLANAGAN. Can I add one other quick factor? I want to mention also, because this committee has worked on it, there is some direct—there has been some predatory direct-to-consumer lending in the private market and the Transparency Act that you have worked on that I know now is in conference with the Higher Education Reauthorization, it would change underwriting laws so that all private loans would have to also go to the financial aid office at the college and then the financial aid office, sometimes they

don't even know that the students have gotten these things and filled out these loans and they can bring them in and counsel them. That is a really important step this committee has worked on and we thank you for your work.

Senator REED. Thank you very much. May I make one more comment, Mr. Chairman?

Chairman DODD. Certainly.

Senator REED. My time is expired, but there is another aspect of this, too, and that is the lending that parents have done entirely outside of this whole system by just going and getting a second mortgage on the house and sending the check to the school. That, I think, is another issue that is putting huge pressure on families where they can't do that any longer. So this demand is going to uptick, now looking at the Federal programs, private education loans, because the house is no longer the ATM, and that is something it is hard to factor in, but that has to be a factor.

Chairman DODD. Well, if I may just pick up on Senator Reed's point, credit cards, I mean, this is the one that really scares the heck out of me. The Washington Post reported, reflecting escalating college costs, 55 percent said they charged their books, and nearly one-quarter, 25 percent, said they pay their tuition with a credit card. So one out of four is paying tuition with a credit card. And obviously when you are talking about rates on credit cards, it——

Senator REED. Fix that.

Chairman DODD. Yes, fix that, Jack says. Thanks. They are getting in some cases 20, 25 percent rates of interest because they don't—navigating this system—it isn't just—anybody, I don't care how well educated you are, this is complicated stuff, and to sort it out and make sure you are getting exactly what you deserve, given your financial circumstances, is complicated.

I can just tell you, for the hearing today, getting ready and sorting out the various ideas and programs and how they mesh together in a way is a complicated task, to ask the questions of those of you who do this every day. So the credit card problem is a growing one.

And I pointed out earlier—somebody said this and I didn't get a chance to ask you about it, but the correlation directly, not just as a financial matter this is spreading, but the idea that on the Student Loan PLUS Program that you are disqualified from that program if you have been in foreclosure on your home in the last 5 years, so that 14-year-old—and we have 1,000 people a day who foreclose on their homes. Eight thousand file for foreclosure. A thousand today actually foreclosed. What we are doing to that family today, denying them the opportunity to even qualify for student loans, well, that program, not all of them, but that one program—anyway, Senator Corker.

Senator CORKER. Thank you, Chairman Dodd. I listened to all the testimony but had to step out and miss some of the questions. I think I am not being redundant in asking this question.

The Federal Financing Bank has been talked about as an immediate solution, and what we do here legislatively mostly is very clumsy and I think mostly misses the mark as far as trying to—I don't think we have even come close yet to focusing on the issue of liquidity. Yet it seems that there is a very simple solution, espe-

cially based on timing issues that all of you face with students and next fall.

I was a little surprised with Senator Reed's questioning that last year's efforts, if you will, to take some money out of the private side, you had mentioned, was really not a problem, candidly, because the testimony I read from others says that it is. So it seems to me that we get back to again the first witness and talking a little bit about the Federal Financing Bank and it seemed like to me it is a surgical solution that works and is immediate and is the thing that will solve mostly the problem you are confronting. Do all the witnesses agree with that?

Mr. DEUTSCH. Yes, absolutely.

Senator CORKER. So if that is the case, talk to me a little bit about what risk, if any—we understand there is very little risk, but what risk, if any, the taxpayer has in regard to using this vehicle, which again seems very surgical. It keeps legislators out of this, which mostly muck things like this up. Talk to me about the liabilities, if you will, from the taxpayer side.

Mr. REMONDI. Sure. Thank you. One point to just be clear, when you talked about the reduction in the yield that lenders received last fall, it was in the context if funding spreads were the same, at ten basis points——

Senator CORKER. Right, but with the Federal Financing Bank issue, what you are talking about, it seems like it does get it back to a spread that is reasonable, is that correct?

Mr. REMONDI. Yes, although if those legislative cuts had not taken place, FFELP lending would be profitable today and so the situation would not be as extreme as it is. As in anything, it is never one thing that causes all the problems, but——

Senator CORKER. Right.

Mr. REMONDI [continuing]. It does compound them dramatically. I want to just make that clear.

Senator CORKER. I think you are just putting an exclamation point on the unintended consequences of what we do here, but——

Mr. REMONDI. Correct. Now, in terms of the credit risk, the way we have recommended the Federal Financing Bank structure this program is that they would advance to lenders only against the government guaranteed portion of the loan, and so taxpayers in that sense would not be taking credit risk. If a borrower were to default, the payment would be coming to a lender in any case, regardless of where the funding source was, from the Department of Education, and that guarantee is up to 97 percent of principal and interest. So we are suggesting that the Federal Financing Bank only advance against that 97 percent and that the lender retain that risk-sharing component on their books. That way, the taxpayer is protected against any credit losses from students not paying their loans on time.

Senator CORKER. And that effort alone would reconstitute liquidity in the market and basically cause student lending to be off and running at norms?

Mr. REMONDI. Yes. We believe the direct injection of liquidity would be important by itself, but we think there are also significant benefits from investors, as well. We think investors will look

at this step by the Federal Government as support for this program and will hasten their return to the asset-backed securities market.

Senator CORKER. So there is another solution offered in addition that talked about being able to access the Fed window. That would actually not be necessary under this scenario, is that correct?

Mr. REMONDI. That—it would not be necessary, that is correct. I think it is an additional benefit, and as any—one of the issues that we face and investors face in the term asset-backed market is liquidity is generally I don't trade with you when I am buying or selling a security. I go through a bank who acts as an intermediary, and banks right now—in the past, they would often hold these assets in their portfolio for a brief period of time in inventory, if you will, before they would find the buyer to match off against the seller. Right now, they are not doing that because they also have balance sheet constraints.

The ability to borrow to pledge these securities to the Fed or through the Home Loan Banks, we believe creates funding for the intermediaries to create a more orderly secondary market, and that is—it is not a measurable benefit, per se, but we think it would have a significant impact on the trading of these securities in the marketplace.

Mr. DEUTSCH. Senator Corker, if I might interject, I think the Federal Financing Bank would be as focused on the FFELP lending program and would provide direct liquidity to that program. I think the Term Securities Lending Facility, if AAA student loan asset-backed securities, both FFELP as well as private student loans were eligible collateral for that facility, it would help not only the FFELP program, but also the private student loan program, and I think that is one distinction between how the FFB could play an integral role in terms of helping originate FFELP loans, but also the lending facility could help provide additional liquidity in the private student loan market, which we have heard, I think, is very important for a lot of students today.

Senator CORKER. In the event, though, we were able to cause the FFELP program to reignite, if you will, and move ahead, the consequences of that over a short amount of time, though, would actually cause liquidity to return even on the private side, would it not, without the action you are talking about?

Mr. DEUTSCH. Correct. I think by helping the FFELP lending market and providing liquidity directly there, it would provide effectively, if you think about all the capital out there, if investors, institutional investors aren't purchasing now the FFELP-backed student loan asset-backed securities, they can put that capital to work in the private student loan market, which ultimately would drive down those spreads.

Senator CORKER. Mr. Chairman, it is very seldom that people are able to come before us with a very simple solution to a pretty complicated problem that affects so many people, and I don't know what the full content of the letter you are talking about has in it, but I know that our Tennessee delegation is signing one that certainly focuses on this issue that they are bringing forth. I look forward to seeing what yours says. But it sounds like that without us, if you will, taking prolonged action that ends up being sort of cum-

bersome, there may be a solution to this. And I appreciate you very much coming to this hearing today.

Chairman DODD. Well, I am going to give you a copy of a draft of the letter in the next few minutes and have you look at it. It doesn't require any statutory authority. Obviously, this exists, so you don't have to go through—it is just a question of urging those in a position to do something about this and I think it would be a real help.

I also believe, look, I mean, the subsidy cuts, people are talking about it, but I think the credit crisis, I think we would have weathered all of this with the subsidy cuts without any problem. I don't know if the witnesses would agree with that. I know those who raised that issue. But to my view, it is the credit crisis, not the subsidy cut, that finds ourselves in the situation we are in today.

Mark, did you have any quick comments on any of this, particularly on Tom's point, from Senator Corker, on the second phase of this, on the private lending?

Mr. KANTROWITZ. Well, one aspect is the Federal Financing Bank has that $15 billion limit, and it is a $90 billion student loan market, so having the Term Securities Lending Facility accessible would also benefit in that regard.

Chairman DODD. Senator Brown.

Senator BROWN. Thank you, Mr. Chairman. Senator Corker talked about providing liquidity for the private loans and I would like to for a moment, from your testimony, Mr. Remondi, ask you a question. You had talked about providing liquidity for federally guaranteed loans. You said under this proposal the Treasury or some Federal Financing Bank would purchase through the life of the loan participation interest in pools of newly originated guaranteed loans from eligible FFELP lenders. Why not just buy the loans?

Mr. REMONDI. They could, although the loans are not fully guaranteed so that under the Federal Financing Bank statute, and I am not an expert in this in terms of what their rules or regulations are, but my understanding is they can only buy or finance assets that carry an explicit government guarantee. Federal student loans are 97 percent government guaranteed and so we have structured the proposal so that they can finance against that piece of the loan itself. The lenders would retain the risk sharing or the 3 percent risk that Congress had intended to begin with.

Senator BROWN. Treasury could do that, though, in your understanding?

Mr. REMONDI. I mean, I suppose—I don't know if they have statutory authority, Treasury would have the ability to buy loans, 100 percent of the loan interest directly. I can't answer that. I am sorry.

Senator BROWN. Fine. Thanks. Ms. Flanagan, I want to go back to what Chairman Dodd was talking about direct lending, that we have heard a number of suggestions on how to address the credit crunch with or without legislative change. Just one option for members that I haven't heard—I don't think I have heard discussed today, nor have my staff—sorry I came late—can't they switch to direct lending?

Ms. FLANAGAN. Yes. For the Federal loans, you are seeing a lot more schools going through the certification process, and there are a couple of factors with direct lending that you need to be aware of. One is the Secretary says you can only double it. Now, that is a pretty good downpayment, because if we have got close to $20 billion now in direct lending, you could go up to $40 billion, and that certainly is an action that many, many colleges are doing.

One of the problems at the smaller colleges right now is this is absolute crunch time. I mean, literally, the last of the financial aid offers to families went out last week. They have to make their decisions by May 1. If you have got a small, lean staff, your ability at the same time to go through the software and the transitional issues—I think you will see more and more schools trying to do that over the next couple of months. It would be wise on their part to become certified. But we are just not sure that the Secretary—she has said she can only double it, so we may or may not still have a gap after that. But direct lending is absolutely an option and it is one that many schools are pursuing.

Senator BROWN. A couple of weeks ago, I had 40-some Ohio college presidents come to town and I spent much of the day with them. Some smaller schools—and I am not clear on this and maybe you can clear it up—some of the smaller private schools were talking about the difficulty of switching to direct lending. Is that what you were touching on there?

Ms. FLANAGAN. It takes some time. It just takes some time, and one of the things that would be wonderful is if the Secretary could kind of look at it from the schools' point of view and say, are there ways to make the certification process faster for right now? Could we make it easier for schools? But yes, they are busy, particularly in the next 4 weeks, and it does take some time. You have got to get software. You have got to get people trained. I mean, there are absolutely appropriate due diligence things, but it absolutely is an option.

Ms. MCGUIRE. Senator Brown, I asked my financial aid director this very question the other day, and if she had a gun, I wouldn't be here today. Not to use administrative hang-ups as an excuse, but the reality is the smaller institutions, what Sarah said is really true. There are both limitations of the hands-on-deck, if you will. This is crunch time. This is the time when the financial aid offices are trying to get the packages out the door. There is a lag time with the approval process to get certified and so forth. There are software and technological issues that many of us, you know, we need a run-up period to that and we haven't even budgeted for the impact of doing that.

A lot of times, people have a hard time understanding why higher education costs so much. For us smaller places, at least, we can tell you every dollar, and if we haven't budgeted for a software conversion in a given year, we have to put it off to another fiscal year, at least. So——

Senator BROWN. For either of you, Ms. McGuire and Ms. Flanagan, is there—one of the conversations I had with somebody from the—the chancellor in Ohio, his operation, and some of the presidents, is there a way the States can assist by pooling in some ways several smaller 4-year or several smaller private schools—well,

they wouldn't necessarily be private, but smaller, more likely to be private—to assist with this?

Ms. FLANAGAN. With the direct lending——

Senator BROWN. Yes, with switching to direct lending. If five or six schools have the bureaucratic problems that you mentioned, Ms. McGuire, just the budget problems and all, can they work together on a regional, State, whatever level to——

Ms. FLANAGAN. They might be able to. Schools that are in direct lending love it and there are passionate debates which we stay rather neutral to. But people that are in it love it and there might be some assistance that they could provide——

Senator BROWN. But say if you have a dozen schools in Ohio that want to switch from FFELP to direct lending, could some outside force or some cooperative among them make that job easier?

Ms. FLANAGAN. I think they could.

Ms. MCGUIRE. You know, I don't know if there is any regulatory inhibition. I am a fan of consortial efforts, if you will, and would like to see the model to do that. Unfortunately, I don't think D.C. is the place that will start it, so if Ohio does it, I would love to know.

Senator BROWN. Thanks. Consortial. I have never heard that word. Thank you for that.

Ms. MCGUIRE. A consortium with——

Senator BROWN. A consortium, I understand——

Ms. MCGUIRE. Consortiums, yes.

Senator BROWN. That is the third participle Latin for something. Never mind.

[Laughter.]

We have seen continued—sorry, Mr. Chairman. We are seeing obviously higher interest rates in private loans and we are going to continue to likely see them going up. If credit markets, as most of us believe, are driving the price higher and higher, why not create the direct—and this is for really anybody on the panel. I would like to hear from as many of you as would like—why not create to the private markets a direct Federal alternative?

Mr. KANTROWITZ. There is an alternative originator provision in the Higher Education Act so that the Department of Education could have its own originator, bypassing the schools. There is also provision for consortia of schools to get together and originate direct loans. I have heard that it would take the Department of Education 6 months to set up an alternative originator. They have yet to do it.

Senator BROWN. Anybody else?

Mr. REMONDI. Well, I think it is important to note—I mean, for some reason, 80 percent of schools have chosen to participate in the FFELP sector versus the direct lending sector, and I am sure as any program has its fans operationally on both sides, but today, 80 percent of schools are choosing FFELP for probably some of the reasons we have heard here today.

We are trying to present a solution that addresses the problem for this immediate timeframe, this summer's academic lending season. This is not meant to be a permanent solution, it is temporary, and once we get over this hump of helping students pay for college this year and make sure they get in, we can then take, I think, a

longer look at what is the best solution from a long-term solution, not a temporary solution.

Senator BROWN. Real briefly, Mr. Chairman. So to be clear, 80 percent of schools, representing what percent of students, Mr. Remondi, do you know?

Mr. REMONDI. I think it is probably 80 percent of students. Eighty percent of loans get made in the FFELP sector. Direct lending's share, I think, was 18 percent last year.

Senator BROWN. Thank you, Mr. Chairman.

Chairman DODD. Well, it is a good point and I am particularly interested in hearing you say the consortia—there is a regulatory framework which would allow that. I think it is a very good point Senator Brown has raised. We get a lot of these small, independent schools of relatively small populations and tight budgets, the idea that they could form a consortia and apply as a consortia for the Direct Loan Program, I am glad to know that exists.

I am disappointed to hear that the Department, as you say, is not funding this, or what are they not doing?

Mr. KANTROWITZ. The alternative originator provision has never been used by the Department. They have never set up a contractor to make loans to these students directly as opposed to requiring the schools to take on the administrative burden.

Chairman DODD. Yes. Senator Menendez.

Senator MENENDEZ. Thank you, Mr. Chairman. Let me thank you for having this hearing. I share the concern about all students having access to the possibility of a loan, but particularly low-income students because there was a time that I was in that category and pieced together financial aid in order to be able to go to a private institution in New Jersey who largely serves first-generation immigrant families for which it is a portal to educational opportunity and who have told me that they are feeling the crunch. So this is a real concern.

But I am trying to—and I was watching from my office before I came here some of the testimony—I am trying to get a sense of how much of a challenge we have so that we can get a sense of the urgency of the matter. There are those who say this is being overdramatized, particularly student leaders who suggest that this is being overdramatized for the purposes of the loan companies making an issue about the subsidy cut and there are others who say it is real.

So if you had a son or daughter applying for financial aid this year, on a scale of one to ten, ten being the worst, how would you describe the concern for them to get a loan?

Mr. REMONDI. I would put it somewhere between nine and ten right now, Senator.

Mr. DEUTSCH. I would agree.

Ms. FLANAGAN. We are not seeing problems at colleges yet, and I don't want to scare families. I actually have one of those children. My first of three is going to college this fall, so I am seeing this at both ends.

Senator MENENDEZ. So am I. I have one going to law school and I am trying to figure out what to do with him.

Ms. FLANAGAN. It is scary. And I think the real—the folks who are scrambling are not the parents and the students right now. The

colleges are scrambling. Somebody drops off the lender list. They are scrambling to get new people. So far, they have been successful at that and it will be the schools' job to scramble on behalf of the parents and students, and I think if they have any concerns, they should just walk right into their financial aid office and the colleges will do the work of finding the lenders.

I am not trying to discount the fact that we could face a real financing problem. That is why we are all here today. But I think as far as sending—I don't want to send any signal to Americans that this system isn't going to be there for them, because I believe it will be and I believe one of the reasons it will be there is because we are having this hearing today and people are talking about it and people will find the alternatives.

Senator MENENDEZ. Mr. Kantrowitz.

Mr. KANTROWITZ. I believe that from the PLUS loan eligibility issue that Chairman Dodd mentioned and from tightening credit underwriting criteria for private student loans, at least 100,000 families are not going to be able to get those loans. So I think that just a percent or two of families are going to be directly and immediately impacted.

As far as lender availability, I am more concerned about what is going to happen a year from now if there is no thawing of the capital markets and there is no government intervention.

Senator MENENDEZ. Let me ask you this, Ms. Flanagan. You said that when Secretary Spellings said that she could double the amount of the new loans, they could double the amount of the new loans made to students, if necessary, you said you are not sure if that is enough, or you are not sure if the Secretary would, in fact, double it?

Ms. FLANAGAN. Both.

Senator MENENDEZ. Well, let us assume that it is doubled. What is the difference between the universe that is needed and the universe that exists? Do we——

Ms. FLANAGAN. That would leave about 60 percent of the borrowing, of the $90 billion, if you added up private and the FFELP lending, about $70 billion of that is FFELP and about—or $70 billion of that is the Federal Loan Program, and of that—$20 billion is in direct lending, so she could go to $40 billion, and you have $90 billion altogether, which includes the private loan value. So you have a $50 billion gap. Now, we know there is some liquidity out there, but I just don't know how much.

Senator MENENDEZ. Jack, do you want to make a comment on that?

Mr. REMONDI. Well, as I said in my prepared remarks, I mean, right now, every loan we make today we are making at a loss, and I think every lender is in this same set of circumstances, and we are losing money before operating expenses, so it is that sizable loss issue. There is a limit to how much people will lend to Sallie Mae so we can then turn around and lend it at a loss. Not many people are in that business.

I think each lender will have to ask themselves if there is no solution here and there is no long-term viability for the Federal Loan Program, that it has to be remade into something else, is do we lend at a loss this year? Do we continue to do it? Do we stop? Do

we just exit and pull up just as the 50 lenders that have already done so have demonstrated there.

Mr. DEUTSCH. I think on the rest of the market, Sallie Mae obvious is a very large player in the market and has had and still has continuing access to the capital markets, even though it has been at substantially higher spreads. There are still a number of lenders out there, not just the larger players but the smaller players, who just simply have no access at virtually any rate to be able to access the capital markets and the results of that are that those lenders simply can't originate any new loans.

I think the question of can the government Direct Lending Program, say, go from 20 percent of the market share to 40 percent of the market share, we have already seen effectively $8 billion disappear, and I think we already expect, and it has been alluded to, that we expect a substantial amount more than that. So will that 20 percent, even if it was effectuated flawlessly, would that 20 percent be enough even on the FFELP side? I believe it is going to cause some serious concern as it gets closer and that doesn't include all the associated costs of switching over, of forcing colleges and universities to change their systems, incur the costs of new computer systems, et cetera.

Again, the key point here is the timing, is that lenders are making the decisions now to lend. Students are going to be applying here in the next month, 2 months, for their student loans. So it is critical that that would be very difficult in a shortened span between now and, say, June, July, for all of those colleges and universities en masse, not just one or two, but a massive amount of those colleges to be able to switch over.

Senator MENENDEZ. So let me close. You both said anywhere between eight and ten in terms of my scale of gravity. Mr. Kantrowitz, you said 100,000 families——

Mr. KANTROWITZ. Yes.

Senator MENENDEZ [continuing]. Would not have the opportunity. Let me ask this last question, which is a little bit different dimension of the issue we have been talking about, but I think may be integrated. That is we are seeing a trend of lenders increasing the credit scores that are necessary to qualify, from the 620 to a 650. There is also some concern that some lenders are denying loans to students from schools with lower graduation rates, which often tend to be colleges with lower-income students. I am wondering, are these tougher requirements a symptom of a tightening market or do we have other things in play here?

Mr. REMONDI. Well, from a lender's perspective, they are certainly symptoms of a tightening market. But I think it is important to note, if we lend money to a student who does not complete their education, our view of that is that that student has now been harmed. They have incurred a debt burden and gotten no economic benefit from the college that they were attending. And so we work very hard to make sure that when we are lending to students, we understand what potential graduation rates are and that we are investing with them to pursue this higher education that will help them achieve their degree.

Senator MENENDEZ. I understand that and I agree, but are you looking at institutions or at the individual?

Mr. REMONDI. We are looking at—unfortunately, you know, you take ten kids at a school or 100 kids at a school, it is very difficult if not impossible to determine which kid is going to graduate, so you do look at graduation rates at the school——

Senator MENENDEZ. Are there kids today that would be denied an opportunity for a loan under your new set of standards that would not have been denied before?

Mr. REMONDI. Yes. Our standards have tightened this year.

Senator MENENDEZ. Yes?

Ms. MCGUIRE. Senator, may I just—there is a footnote in my formal testimony about graduation rates, and since you raised it, and I alluded earlier to this issue of tightening credit standards for certain students, I think it is very important to point out that the very students who need exactly this kind of Federal financial aid support, need the loans, both the federally guaranteed loans and even the private loans, are those who at times may look different from good credit risks, and that is part of what is a subtext of this whole discussion, if you will, that needs to be illuminated.

The traditional method for calculating collegiate completion rates is deeply flawed and I, for one, am very concerned that lenders are using a rate that does not, in fact, actually reflect the number of students who complete college. The current rate used by the Department of Education is based simply on one cohort of students that enters 1 year and is tracked through the same institution for a 6-year period of time. A lot of students who leave one institution go to another institution and complete are treated as drop-outs. So there are flaws in the graduation rate method that are serious.

The second thing is, there is clearly a disproportionate impact on low-income African-American and Hispanic students in this use of graduation rates and other kinds of criteria that discriminate against students and institutions who educate the neediest students in the country. Now, at Trinity, I am very pleased that we have an excellent completion rate for the population we serve. It is not as high as institutions that serve a middle-class population, but by the same token, I know a lot of institutions who are doing great service and the lenders need to be careful about the kind of benchmarks they are using in making these judgments because it will harm the very students who need the assistance.

Senator MENENDEZ. Well, Madam President, and I do like that term, Madam President——

Ms. MCGUIRE. Thank you. I do, too. Thank you.

[Laughter.]

Senator MENENDEZ. I raised it because I am concerned about what I hear is an increasing chorus, because under some of the standards that are now being effectuated, I might not be here today.

Ms. MCGUIRE. Right.

Senator MENENDEZ. And we have to make sure that that is not a reality across the spectrum. I understand the difference between the type of appropriate lending requirements to ensure that there is safety and soundness, so to speak, but there is also an opportunity to move in a direction that I don't think we want to see. So we will be looking at it.

Thank you, Mr. Chairman.

Chairman DODD. Let me just underscore the point Senator Menendez has made, and we have had hearings in the past on this very subject matter. This committee marked up the legislation that is now part of the higher education conference that is going on. This is redlining. This is redlining. That is all it is. We saw this practice being done in mortgages, where people were being excluded because of patterns of behavior and exactly the point that President McGuire has raised here.

The idea that we would deny a young person the opportunity to get that loan based on the historic performance of that institution, in this day and age, that is just an unacceptable answer, in my view. Today, we have the capacity and ability to make far better determinations than sort of having a blanket approach where we write off institutions because they take chances on children who come from very different economic circumstances. I am just going to do everything I can to see that that stops. That is just inexcusable, in my view.

Ms. MCGUIRE. Thank you, Senator.

Chairman DODD. Well, it is tremendously important, and the other point, I think, Bob, you heard me raise here, and I will turn to Senator Schumer very quickly, but this whole notion, as well, about the foreclosure on the Federal PLUS Loan Program, where if you end up with a foreclosed property, you are excluded from that program for 5 years after the fact. And that, again, goes right to the heart of this. The idea we deny a child or a family from getting a higher education, particularly in this environment we are living in, who got lured into subprime loans—60 percent of them, of course, qualified for prime lending and they got lured into subprime loans where people were being paid commissions based on how high a rate they could charge you and get away with it and that person ends up in foreclosure and then their children are denied a college education on this is sick, in my view, and that has to change.

Senator MENENDEZ. Mr. Chairman, that is the equivalent of universal default.

Chairman DODD. In effect, it is. That is exactly the point, a good point. Credit cards, another point. Twenty-five percent of people paying for college on a credit card.

Senator Schumer.

Senator SCHUMER. Thank you, and thank you, Mr. Chairman, for having this hearing. I thank the witnesses. I am sorry I couldn't be here the whole time.

I guess my great worry here is that already students are making decisions either not to go to school, drop out of school, not to go to the school that they deserve to go to, want to go to, because they are worried about the inability to get loans. And the one thing I would say at the outset is this. I think we need a little bit of calming here in the sense that, first, it may well be that the markets bounce back in time, OK. There will be people who drop out, but others will come in and take their place. We have seen with government loans, you know, municipal borrowing, that at first there was a spike and then people said, hey, it is a pretty good deal to lend money to a State government or a port authority for eight or 9 percent instead of the four or five that is usual and they came

back in. So I do not—I think this could become a crisis, but I agree, we are not there yet, and the one thing I would say to people is don't panic, don't change your plans at this point.

And the second point is we will provide some back-up. This is just too important to allow 100,000 people who deserve to go to college not to be there. Whether it is what Senator Kennedy and Senator Miller have proposed, which is that the Education Department ultimately come up and back-up the loans, the Federal Financing Bank, which the administration is looking at it, I think we can say with virtual, if not virtual certainty, like a 98 percent chance, we will not—it is our obligation not to let a single person not go because they can't get a loan, not go to school or continue in school or not go to the school they deserve.

And at least my reading on this issue is there will be a bipartisan strong effort to make sure that doesn't happen, period, and I think we should send some assurances out to all of those who have gotten into college and are ready to start and those who are in college and are thinking of changing. Don't panic, because at this point, A, the markets may come back, and if they don't, we will have to step in. College is our future, and every time somebody who doesn't come—

So my first question, first to Ms. McGuire, have you seen among your students, and then any of you and particularly Mr. Kantrowitz, are already people changing their plans? Have you seen people decline admission who might have gone normally? Have you seen people saying they are going to not continue from junior to senior year or whatever? Are we at that stage yet?

Ms. MCGUIRE. Senator Schumer, certainly not among our students at Trinity, and I do appreciate the passion of your desire to fix this before it becomes a problem. I agree with you, as Sarah Flanagan testified, that we are not at a place yet where we see this as a panic. I am concerned that the buzz in the marketplace is going to make people panic needlessly and that is a serious concern.

Senator SCHUMER. Right.

Ms. MCGUIRE. Now, I will also say that because of the students we serve at Trinity, which again gets back to who needs these loans the most, they are frequently independent students from low-income families who don't have a history of even applying for financial aid. They often do all of this very late, and the other side of the coin that I worry about is, we have students—we enroll our students and we admit them to school when they haven't even finished their financial aid packages and we manage something called receivables, which is also another thing I didn't even testify about.

Senator SCHUMER. Right.

Ms. MCGUIRE. My concern is that we will have all these students in school in the fall and then somewhere around October, November, December, we will see them being denied loans when we admitted them and brought them in and will take care of them and we can't afford that.

Senator SCHUMER. That is a great point, and it is also you hear these things and it is so confusing. My daughter applied to law school last year. I have one in college. We can afford on our salaries to pay for college for both kids, but not graduate school. It was Yale

Law School in my good friend's State and I got the little booklet, you know. I am a lawyer. I didn't understand it. There were so many questions that I had about this.

So one thing that is really important, and this relates to a longer term, is disclosure in the higher education bill which is now in conference, a provision for the so-called Schumer Box, which I had written, and I know Senator Dodd had supported and helped put in the bill, to make it very clear all of these points which helped with credit cards and can help with student loans. I was just amazed how confusing it was.

Ms. MCGUIRE. I appreciate that.

Senator SCHUMER. And I think that added to all the talk in the markets and the talk and everything else and people say, the heck with it, because it is hard to work your way through. And then we had a nice lady at the law school, we got her on the phone and she helped walk us through it. But we didn't know—it was so unclear when you start paying, when the interest rates start compounding, which was a better plan for us and our family situation. So that is a very important point and I would urge all of my colleagues that we pass this bill that is now in conference, the higher education bill, to clear this up as quickly as possible. It is a big improvement and it is in conference now.

But I wanted to ask you, Ms. Flanagan, the same question I asked Ms. McGuire. Are you finding people already, are you hearing from your member institutions?

Ms. FLANAGAN. Ask me in 4 weeks.

Senator SCHUMER. OK. It is too early to tell yet.

Ms. FLANAGAN. The deposits are due on May 1 and it will take us a couple of weeks to find out——

Senator SCHUMER. And do you agree with the view no one should panic at this point?

Ms. FLANAGAN. Absolutely.

Senator SCHUMER. OK, that there is——

Ms. FLANAGAN. I said it two or three times this morning and I say it again.

Senator SCHUMER. OK. Mr. Kantrowitz.

Mr. KANTROWITZ. I have already heard from schools that have had lenders representing 50 percent or more of their loan volume exit the program, and these schools then have to scramble to find new lenders for——

Senator SCHUMER. And how are they doing with that?

Mr. KANTROWITZ. They seem to be fine. They haven't had trouble finding new lenders as of yet, but there has been no sign of any calming of the capital markets and every day, I hear about new lenders leaving the loan programs.

Senator SCHUMER. Right.

Mr. KANTROWITZ. I have also heard from students, and this is all anecdotal, one-on-one, that are worried about the situation and they are considering attending less-expensive schools.

Senator SCHUMER. Yes. I worry about that, too.

Mr. KANTROWITZ. So I haven't heard of any students dropping out except for the Silver State Helicopters issue, but their students are very worried about this and it is affecting their college choice.

Senator SCHUMER. Yes. Well, just my reading of it, again, as one Senator who has been around a little while, not as long as some, we will have to step—if somehow the markets, they can't find replacement lenders, more people drop out, we are going to have to step in. There is no question about it, and last night, I talked to my landlord, who happens to be George Miller, and my roommate, and he is pushing that the Education Department do it and he thought that would have pretty easy sailing in the House. Senator Kennedy is doing that in the Senate, and then there is, as I said, the Federal Financing Bank, which the administration somehow or other, we are going to have to—this would be just unpardonable to let happen in housing happen here now and not move in early and quickly. So I think it will.

Any comments from you, Mr. Remondi or Mr. Deutsch?

Mr. REMONDI. We have seen, in April so far, we have seen a 26 percent increase in applications over last year, so clearly students at these schools that have lost lenders are finding their way to Sallie Mae. I think the vast majority of lenders are continuing to lend right now, but they are looking for a solution and we are hopeful and very pleased at your comments and support that something needs to be done, and we think the Federal Financing Bank is the best solution for the time at the moment.

Senator SCHUMER. Right. Mr. Deutsch.

Mr. DEUTSCH. Senator Schumer, I think it is critical that the government exercise some leadership in this regard. I am very heartened by your comments, and I think the market should be very heartened by the comments that the government will take steps to make sure that students do have access to loans. I think right now, it is very disconcerting to lenders to be originating loans effectively at a loss.

Senator SCHUMER. Right.

Mr. DEUTSCH. That is just an unsustainable business model. I don't think anybody here, anybody in this room wants to see any student——

Senator SCHUMER. Mr. Deutsch, in the last week, is the trend getting better or worse? I know it is——

Mr. DEUTSCH. The trend has gotten worse.

Senator SCHUMER. OK, up until this moment?

Mr. DEUTSCH. I think the trend has gotten worse and I think the trend will continue to get worse over the ensuing weeks.

Senator SCHUMER. OK. Thank you, Mr. Chairman.

Chairman DODD. Great points, Senator, and I, in fact, made the point at the outset of the hearing that I call this a concern. Now, you may calibrate "concern" however you want, but I agree, the last thing you want to do is have panic set in. But as my colleague from New York will tell you, as I mentioned, a year ago, we had the concerns about the residential mortgage market and we tried to get people to react to the concerns and, of course, we had a lot of delay and timidity in the process and we ended up with a crisis.

Senator SCHUMER. Yes.

Chairman DODD. So I agree with you here. I can't imagine anyone allowing this problem to slip into the crisis phase, but I don't want to make the mistake we did a year ago. I didn't think that would happen, either, in that issue, and——

Senator SCHUMER. Mr. Chairman, that is why I think these hearings were timely and appropriate and needed and I am glad you held them.

Chairman DODD. And, in fact, before you came, Senator Corker indicated an interest. We are going to put a letter together today, Chuck, to Secretary Paulson on the Federal Financing Bank issue, which really does two things. First of all, that program only affects the FFELP program, but if you can begin to unleash capital there, we also think it would work into the private lending area, as well. So it could have the benefit there.

There is a second phase of this thing and that is access to that discount window, but that would take a little bit more of a hurdle for some going over than I would, frankly. But nonetheless, we think it would help.

So we are going to continue to monitor this, but this hearing has been helpful and raising these issues are tremendously important. So we will continue to urge involvement. We will leave the record open. I know that other members would like to raise some additional questions.

You have been terrific witnesses, all of you, very, very helpful. I can't tell you how much I appreciate your testimony this morning.

With that, the committee will stand adjourned.

[Whereupon, at 12:11 p.m., the hearing was adjourned.]

[Prepared statements, responses to written questions, and additional material supplied for the record follow:]

PREPARED STATEMENT OF SENATOR JOHNSON

Chairman Dodd, Thank you for holding this hearing on the effect of the credit crunch on student loans. Many students have just received their acceptance letters from colleges and universities across the country. Those same students are now faced with the daunting task of finding the means to pay for their education.

Families must now fill out the complicated FAFSA for federal aid. According to the College Board, Stafford Loans provided $63.9 billion in new loans to students and their parents in Fiscal Year 2007. The Federal Family Education Loan program provided 11,359,000 new loans averaging approximately $4,494 each, and the Direct Loan program provided 2,791,000 new loans averaging approximately $4,603 each. While these loans are not within the jurisdiction of the Banking Committee, many of the 14,150,000 students who received federal aid may face fewer and more expensive options because of tightening credit and a slowdown in the auction-rate securities market.

I have heard from lenders and the student loan guarantee agency in my state and they are working hard to ensure that students have the funds necessary to attend college, but every area of the country is not as fortunate, and lenders in South Dakota do not exist in a vacuum. After raising my concerns with Treasury Secretary Paulson and Secretary of Education Margaret Spellings, their response, dated March 28, 2008, stated that, "we too are concerned about the recent auction failures in the student loan sector, we believe they reflect a general stress in the credit markets rather than specific concerns about the underlying student loan collateral."

Even if the collateral is good, if there is no way to securitize the debt, lenders will be unable to offer the same number of loans that they have in the past. Private loans are also facing the constraints of the market and yet they are increasingly necessary as working families struggle with the high costs of post-secondary education. It is my hope that this hearing will bring greater light to the challenges that face student lenders and borrowers. The witnesses today also have a forum to suggest ways to provide additional liquidity for student loans and maintain access to college for students.

Student loans are an investment in the productivity, innovation and excellence of our nation's children and its future. We cannot throw up our hands and tell our college-bound children to wait out the credit crunch. It is

our responsibility to ensure that opportunities for higher education do not become a victim of the current market situations.

PREPARED STATEMENT OF SENATOR DOLE

Thank you Chairman Dodd and Ranking Member Shelby for holding this very important hearing today. Parents and students need options when it comes to student loans, and they need to know that they can meet the expenses of a college education. That said, according to a recent *New York Times*/CBS News poll, 70 percent of parents surveyed were "very concerned" about how they would pay for college, and only 6 percent were not concerned.

Mr. Chairman, with this hearing we are recognizing that the downturn occurring in the financial and housing sectors will impact student loans. We have already seen nearly two dozen lenders that have been unable to raise money to issue new loans and have dropped out of the federally-backed student loan program. Other lenders have been able to step in to cover the loans, but what happens if more lenders drop out and there are too many loans for the remaining lenders to cover? When considering how interconnected our markets are, it is not too farfetched to presume the problems could extend to student loans.

Colleges and universities are not taking any risks, and there has been a substantial increase in the number of institutions that have applied to participate in the direct loan program. According to Secretary Spellings, the Department of Education can meet this demand. If necessary, the direct loan program could double the number of new loans it issues

The greatest potential for problems exists with parents and students who are forced to seek private loans as a means to afford college because the future accessibility of these loans could be in jeopardy. According to a GAO report, between the 1995-1996 and 2006-2007 school years, overall enrollment in U.S. higher education institutions increased by about 19 percent, or more than 2.2 million students. With rising college costs, families are increasingly relying on private loans to cover the gap between tuition and the federal loan options that are available to them. According to the Congressional Research Service, in 2005-2006, the average price charged for tuition, fees, room and board at four-year public and private institutions was $17,447 — a 577 percent increase from 30 years ago.

In the face of the current credit crisis, it is becoming more and more difficult for students to procure the loans that make it possible to attend college. Banks are tightening their standards

and raising rates on other types of borrowing—a trend that will most likely extend to student loans. The credit crunch also has made it more difficult for lenders to raise the capital necessary to issue new loans.

In addition, many families have traditionally relied on their most valuable asset, their home, by taking out a home equity loan to help send their children to college. With the current housing situation, however, this option is becoming less accessible, as home values all over the country are plummeting, and millions of families now owe more on their mortgages than their homes are worth. The housing crisis also affects parents' ability to take out a Parent Loan for Undergraduate Students, or PLUS loan. These loans allow parents to borrow the cost of their child's college education, less any other financial aid already being received. According to one of our distinguished witnesses here today, Mark Kantrowitz of FinAid, parents with a foreclosure on their record will not be able to qualify for PLUS loans. So as the number of foreclosures increases, there will be a significant uptick in the number of denials of PLUS loans.

We are seeing evidence of systemic problems in our economy. If the recent financial crisis in the housing sector has taught us anything, it is that we must be proactive, rather than reactive, in taking the necessary steps to ensure that students and families have sufficient and uninterrupted access to student loans.

Thank you to the witnesses for being here today. I look forward to hearing from you and hope this committee will work on consensus proposals to address these timely and critical issues.

Testimony of John F. (Jack) Remondi

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

Tuesday, April 15, 2008

Hearing on the Impact of Turmoil in the Credit Markets on the Availability of Student Loans

Good morning Chairman Dodd, Ranking Member Shelby and Members of the Committee. My name is Jack Remondi, and I am Vice Chairman and Chief Financial Officer of Sallie Mae. On behalf of Sallie Mae's more than 10,000 employees and 10 million student borrowers, thank you for the opportunity to testify on the impact of turmoil in the credit markets on the availability of student loans.

Let me begin by also thanking you and the members of the Senate Banking Committee for holding this hearing. As the nation's leading provider of saving, planning and financing solutions for college, we share your goal of ensuring that borrowers who will need federally-guaranteed and non-federal student loans have the ability to pursue their education plans this fall.

Over the last decade, the cost of a college education has dramatically exceeded the growth of federal grants and loan limits in the Stafford Loan program. Increasingly, credit-based non-federal, or "private" student loans have helped families close the gap between state and federal financial aid, scholarships, limited family resources, and the actual cost of attending college.

Sallie Mae is proud to be a leader not only in the delivery of federally-guaranteed student loans, but in making this "gap financing" available. Often, it means the difference between attending

or not attending the college of a student's choice. At the same time, we understand that the growth in non-federal student loans raises important consumer and policy issues. At Sallie Mae, our policy is to promote a 1-2-3 approach: First, tap personal financial resources and "free money;" second, utilize low-cost federal loans; and, lastly, only as needed to close the gap between available funds and the cost of attendance, take advantage of private loans.

This year, we will see the largest high school graduation class in history enroll in college. Higher education enrollments typically increase in periods of economic downturns. Home equity borrowing, sometimes used to pay for education, is in decline. Due to these factors, demand for federal and non-federal loans is on the rise. The U.S. Department of Education estimates that approximately 7 million borrowers will need more than $68 billion in federal loans this academic year. Private education loans are estimated to add another $20 billion.

Yet, both federal and non-federal student loan markets are under severe stress. For the current academic year lending season, we are facing a scenario where demand for student loans will significantly outstrip the supply.

I would like to use my time here today to describe the current state of the student loan finance markets and Sallie Mae's recent experience in them. And, finally, I will briefly describe key steps we recommend the federal government can take to restore liquidity for this primary source of paying for college.

Over 75% of federal student loans are financed by non-bank, specialty finance companies such as Sallie Mae, including not-for-profit lenders and state agencies that make some loans and buy other loans from banks. Non-bank lenders fund their loans primarily through the term asset-backed securities (ABS) market, while others access a financing mechanism known as auction rate securities (ARS) market. Sallie Mae does the vast majority of its financing through the term ABS market, thus, I will concentrate my remarks there.

In a typical asset-backed security financing, lenders transfer student loans to a bankruptcy remote securitization trust that issues securities to investors. The securitization trust is structured such that the investor looks solely to the underlying loan collateral for repayment of the investment. This insulates the investor from any credit events that may occur over time at the company that sponsored the ABS trust. Typically, these student loan asset-backed securities are given ratings from AAA to AA by credit rating agencies based on their risk and maturities. Asset-backed securities backed by loans made in the Federal Family Education Loan Program, or "FFELP," are consistently rated AAA because each individual loan carries a 97% federal government guarantee. Investors in these securitizations generally receive different floating rates of interest, known as spreads, based on the credit rating and maturity of the purchased security. To meet the demand for loans we expect, Sallie Mae should securitize approximately $2.5 billion in loans a month for the balance of 2008. To date, Sallie Mae's pace of issuance in the term ABS market is 40 percent below this plan. In addition, the limited funding available requires investor spreads that are so expensive that newly originated loans are uneconomical.

The financing of federal student loans is reliant on a well-functioning and well-priced credit market. I am confident you are aware that this is not the environment in which we operate today. The spreads demanded by investors have increased rapidly and significantly since mid-summer of last year. Where we financed last July at LIBOR +10 basis points, recent transactions in the ABS market have been done at LIBOR +140, with spreads doubling in the past six weeks alone.

For non-federal loans, the situation is even worse. Because of the market disruption, there have been no term asset-backed securitizations for private credit-based student loans this year. Sallie Mae last did a private credit term ABS transaction in the spring of 2007.

As a result of today's funding levels, every federal loan funded in the term ABS market generates a negative spread before any operating expenses are taken into account. This unprecedented cost of borrowing, added to the 70 basis point yield cuts contained in last year's College Cost Reduction and Access Act, mean that every loan originated in the FFELP program will be made at a loss.

Because of these economics, upwards of 50 lenders have already ceased or suspended making federal or private student loans. Absent any relief, we expect a major shortfall in access to student loans this year.

It is important to note that given the seasonal nature of student lending, the impact of tightening loan availability is only now beginning to reach students and schools. Demand is always low in

the first quarter of the calendar year, but will increase significantly over the next several months. In fact, three-fourths of all student loans are made from April to September.

It is our view that the gap between available loans and the demand for them could manifest itself as early as May. Between now and then, lenders who have not already left the business of student lending will be faced with the difficult decision of exiting the student loan business or continuing to make loans at a significant loss.

However, the federal government could take budget-neutral steps that would avert a student loan access crisis. Our view is that steps should be taken that are non-disruptive to students, are temporary, and are geared toward guaranteeing borrower access to loans this academic year.

The least disruptive, most cost-effective, most manageable, and quickest proposal to implement would be for the Department of Treasury's Federal Financing Bank, or FFB, to provide liquidity for federally guaranteed loans. The FFB is already authorized by statute to purchase and sell any obligation which is issued, sold or guaranteed by a Federal agency. Therefore, legislative action is unnecessary to make this happen. Upon deciding to exercise this authority and make funding available for new loans, the Bush Administration can do this in time to help.

Under this proposal, the FFB would purchase, for the "life of the loan," participation interests in pools of newly originated guaranteed loans from eligible FFELP lenders. Borrowing costs would be set at a rate low enough for lenders to have an incentive to access this credit in today's

inhospitable environment, but high enough that lenders will be eager to return to the markets when conditions improve.

To ensure the least amount of disruption to the borrower and to relieve the FFB of any responsibility to service the loans, lenders would continue to manage and service the loans under the same strict requirements that govern all FFELP loans. Servicing and guaranty agency agreements would remain with the lender. Consequently, day-to-day administration of the loans would be the responsibility of the eligible lender, not the Federal Financing Bank.

We believe this plan would provide desperately needed liquidity to the FFEL program, and ensure that student access to guaranteed loans is undisrupted. But such an action, if undertaken, would do more than that. It would be a signal to the market that the government stands behind this guaranteed asset. We believe this would hasten a return of investors to this asset class. With front page articles beginning to appear in the nation's newspapers detailing students' inability to get new loans, this plan would help restore consumer confidence as parents and students would know that the federal program specifically designed to provide them access to low cost loans will be there when they need it.

Most important for the subject of this hearing today, I believe that creating liquidity for federal loans would have spillover benefits to the non-federal market as well.

Another proposal put forward that does not require congressional action would have an indirect but positive impact on liquidity in the student loan financing market. Specifically, it would

allow primary dealers and issuers to use student loan ABS as collateral to borrow from the newly created Term Securities Lending Facility (TSLF) of the Federal Reserve Bank.

Although we advocate this change, and believe it will directly benefit the FFELP ABS market, it is unlikely to provide sufficient liquidity to ensure students have access to student loans this year.

Congress, too, is taking action.

Last week, Sen. John Kerry (D-MA) introduced the Senate companion to H.R. 5723, the Emergency Student Loan Market Liquidity Act, sponsored by U.S. Representative Paul Kanjorski (D-PA). S. 2847 would support the student loan financing markets by authorizing the Federal Home Loan Bank (FHLB) system to take federal student loans as collateral for advances, which in turn would be used by lenders to make new loans. The legislation would also authorize Federal Home Loan Banks to invest their surplus funds in student loan asset backed securities. We believe this legislation would be a step in the right direction and we support its passage.

We are also encouraged that HELP Committee Chairman Kennedy and Education & Labor Chairman Miller have both introduced legislation designed to support student access to loans. We look forward to working with both Houses of Congress as this legislation is debated and refined.

In conclusion, the financing environment for student loans is under unprecedented pressure due to the combination of legislative cuts and severe dislocation of ABS and ARS markets. Action is

needed now to prevent a crisis of student access to FFELP and private education loans. We do not have weeks or months to decide the best course of action. The Administration can move immediately to make available advances from the Federal Financing Bank, and that would have the least disruptive, most immediate and beneficial impact on the situation. We hope Congress can urge them to do so without delay. But Congress can do more by passing the Emergency Student Loan Market Liquidity Act and pursuing other liquidity enhancing solutions.

Thank you for allowing me to appear. I firmly believe that Sallie Mae and other FFEL lenders provide a necessary and important service to students, their families and the schools they attend.

I look forward to answering any questions you may have.

TESTIMONY OF

TOM DEUTSCH
DEPUTY EXECUTIVE DIRECTOR
AMERICAN SECURITIZATION FORUM

BEFORE THE

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

HEARING ON

TURMOIL IN U.S. CREDIT MARKETS:
IMPACT ON THE COST AND AVAILABILITY OF STUDENT LOANS

APRIL 15, 2008

Mr. Chairman and members of the Committee:

My name is Tom Deutsch and I am the Deputy Executive Director of the American Securitization Forum ("ASF")[1]. I very much appreciate the opportunity to testify before this Committee today on behalf of the 370 member institutions of the ASF and the 650 member institutions of the Securities Industry and Financial Markets Association ("SIFMA")[2]. These members include not only firms who originate and securitize most

[1] ASF is a broad-based professional forum of over 370 member organizations that are active participants in the U.S. securitization market. Among other roles, ASF members include issuers, investors, financial intermediaries, professional advisers and rating agencies working on securitization transactions backed by all types of assets. ASF's mission includes building consensus, pursuing advocacy and delivering education on behalf of the securitization markets and its participants. Additional information about the ASF, its members and activities may be found at ASF's internet website: www.americansecuritization.com.

[2] SIFMA brings together the shared interests of more than 650 securities firms, banks and asset managers. SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members' interests locally and globally. It has offices in New York, Washington D.C., and London and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong.

of the student loans made in America, but also the institutional investors who purchase securities backed by these student loans. We are pleased to present our views on how the current turmoil in the U.S. credit markets might affect students in the coming lending season.

FFELP and Private Student Loan Lending Programs

Generally, students and their families have two private sector financing options specifically designed to fund higher education expenses—government guaranteed Federal Financial Education Loan Program ("FFELP") loans and private student loans. Both types of products are facing specific challenges in today's capital markets, which I discuss in greater detail below.

The FFELP, a highly successful public-private partnership, has leveraged federal guarantees and funding from the private global capital markets to make available almost $100 billion each year to students in need of financial resources to pay for the costs of higher education. Recently, these originations represent nearly 80 percent of all government subsidized loans with the other 20 percent originated through the Government Direct Lending Program. Since 1965, private sector FFELP lenders have helped more than 60 million Americans attend college by making efficient, low cost student loans. More than 80 percent of all post-secondary institutions have elected to participate in FFELP because they believe the program provides affordable loans and excellent service to borrowers. Due to the increased number of college-age students and rising higher educational expenses, the FFELP program has assumed an even more important role for the current generation of students.

The four pillars that have supported the overall success of FFELP lending over the last 40 years have been: 1) the low cost, efficient funding mechanism the capital markets have supplied to lenders of student loans; 2) appropriately sized incentives to lenders in the form of government principal and interest guarantees and special allowance payments; 3) robust market competition among student loan lenders that keep lender rates low and borrower benefits high; and 4) the universal availability of FFELP loans to all potential students.

Unfortunately, the reductions of federal guarantee rates and special allowance payments during the peak of the credit cycle in 2007 have made origination of student loans uneconomical to a large portion of the student lending market in today's credit constrained capital markets. The combined force of these events over the last six months now threatens each pillar of the FFELP lending program and these developments will ultimately leave some students without access to loans to help pay for their educational expenses. Students with access to education finance loans are finding their overall costs are increasing, as they are now incurring government mandated origination and default fees, in addition to reductions in borrower benefits, such as on-time payment discounts.

Beyond FFELP lending, private student loans bridge the educational financing gap between federal student loan limits and the ever-increasing cost of education in the United States. The College Board estimates that private loans have provided students

with over $18 billion in the 2006-2007 academic year and $77 billion over the last seven years. However, like FFELP lenders, private student loan lenders have also felt a significant impact from the disruptions in the capital markets.

Structure of Capital Market Funding for Student Loans

The securitization industry has been an integral part of the success of student loan lending in the United States, serving as an efficient and cost-effective funding mechanism for originators of consumer and business credit in nearly every sector of the economy including not only student loans, but also residential and commercial mortgages, automobile loans, credit cards, commercial loans and corporate bonds. In 2006 for example, U.S. securitization issuance across all asset types topped $3.1 trillion dollars.

Student loan asset-backed securities ("ABS"), secured by either private lender FFELP loans or private student loans, as well as tax-exempt and taxable repackagings of municipal, state agency and not-for-profit FFELP loans have been the primary financing sources for lenders to raise funds in the global capital markets. For example, 85% of FFELP loans have historically been financed through student loan asset-backed securities or bank facilities, in which originating banks sell participations in pools of loans that they originate. Approximately 75% of holders of student loans are non-depository institutions, which almost exclusively rely on the capital markets for funding. But even depository holders have securitized a majority of their student loan holders as well. As such, over $80 billion in student loan ABS was issued in 2006 with that issuance number declining to slightly above $60 billion in 2007.

Given the stable and predictable returns of the cash flow payments on student loan ABS and repackagings, institutional investors, such as pension funds, mutual funds and insurance companies, have employed the capital from their investment funds to purchase these securities. This fresh capital is then deployed by lenders to make additional low cost FFELP loans to other students.

Increasing Capital Market Funding Costs and Originator Withdrawals

Over the past six months, turmoil in the debt capital markets, including significant repricing of credit risk generally, deleveraging of balance sheets and failures in the auction rate securities market, has eliminated economical access to this financing market for many lenders. No student loan originated after September 30, 2007 has been funded through the capital markets. For the first time in 40 years, no state agency or non-profit has been able to access the capital markets in the first quarter of 2008 to finance student lending. And originators of private student loans have not been able to access the traditional securitization markets since September, 2007.

Further, The Education Resources Institute Inc. (TERI), the largest not-for-profit guarantor of private loans, filed for Chapter 11 bankruptcy protection just last week, further drying up credit protection for this part of the market. Issuers of private student loan asset-backed securities contracted with TERI to obtain 'insurance' on a portion of the credit risk of the securities. Without TERI operating effectively in the market, a

critical contributor to facilitating liquidity for private student loan asset-backed securities will be lost.

For those who have been able to access capital market funding, they are experiencing significantly higher costs that they cannot make back. Spreads on triple-A rated student loan ABS, backed by FFELP Stafford and PLUS loans that are already at least 97% government guaranteed, have widened by 150 basis points, or roughly 15 times the levels seen just last summer. Unlike most other forms of consumer credit, the interest rates charged to students on FFELP loans are set by law, so lenders are not able to recoup these additional costs in the FFELP loans they originate. As a result, only $8.4 billion of student loan ABS was issued in the first quarter of 2008, as compared to $21.7 billion issued in the first quarter of 2007. Put simply, originating new FFELP student loans has largely become a money losing proposition.

As a result of the unprofitability of these loans or the inability to secure any funding at all, 43 lenders have already either exited the FFELP program altogether or suspended lending. Of those 43 lenders, three of the top eight student loan holders (Brazos Group, the Pennsylvania Higher Education Assistance Agency (PHEAA), and the College Loan Corporation) have exited the program. Altogether, the withdrawal of these lenders alone, irrespective of continuing lenders' reduced capacity, represents nearly $7 billion or approximately 15% of overall 2007 originations. But still looming over the next month or two are the decisions as to whether other lenders will continue originating under FFELP and, if so, what origination reductions they will be forced to implement if they do continue their participation in the program.

In sum, the combined effect of last year's significant incentive reductions with the current high cost of credit in the capital markets has increased substantially the potential for severe disruption in the availability of student loans through the FFELP.

Effects of Originator Withdrawals/Reductions on Students

Although we are not aware that any eligible student has been denied a FFELP loan to date, new loan applications are currently at their seasonal low given the structure of the academic funding calendar. In the coming months, approximately 6.7 million students and parents are expected to apply for a FFELP loan, as three-quarters of all student loan volume is originated between April and September. As demonstrated over the last few months by the announcements of lender withdrawals, most originators of student loans have made, or will be making shortly, their capital availability decisions for the 2008-2009 academic year, which highlights the urgency of the need for relief.

Unlike FFELP loans, we believe that some students in search of private student loans have not had access to them already in the current credit-constrained environment. The current turmoil in the credit markets has eliminated many of the smaller firms that had been active in this market sector, and many others will likely be forced out of business as a result of a lack of liquidity and uneconomical costs of operation.

In addition, unlike the mortgage market, there are no government sponsored enterprises to provide funding or temporary liquidity to student loan lenders. Entities such as Fannie Mae and Freddie Mac provide confidence to lenders that conforming mortgage loans can be financed even in distressed market conditions. No such program exists for the student loan market.

Under the Higher Education Act, the Department of Education can turn to guarantors that act as lenders of last resort (LLR), advancing federal capital to loan guarantors when there is not sufficient private capital to meet student demand. However, the Secretary of Education testified before the House Education and Workforce Committee on March 14, 2007 that the LLR program, if required, would be more expensive to taxpayers than loans under the current system. The continued weakening of the debt capital markets and the expected withdrawal of additional lenders from the FFELP will likely result in substantial reliance on the more costly LLR alternative. The LLR program was not designed to address this extremely large withdrawal of lenders from the market, so the infrastructure and operations of the LLR program have never been tested on a magnitude that may be required to meet student demands this fall.
While there have been suggestions of depository institutions stepping in to make FFELP loans where non-bank specialty finance companies have suspended lending, we believe that, due to the impaired economics of the FFELP program and broader liquidity constraints throughout the market, neither our bank nor large non-bank lenders will be in a position to meet increased demand.

Ultimately, if no relief is found, the total supply of loans available through all the various programs will likely not meet student demand efficiently and effectively this fall. As such, some borrowers may not have access to needed government subsidized loans and/or to private student loans to bridge the funding gap. And for those students who have or will have access, borrower benefits such as on-time payment discounts are disappearing and borrower services are declining.

Short-Term Solutions

1. Federal Financing Bank

Given the urgent need for liquidity for student loan originators, the most comprehensive and elegant short-term solution to this developing crisis would be for the Federal Financing Bank ("FFB") to provide additional liquidity to lenders to originate new FFELP loans as well as to the asset-backed market indirectly. The FFB was established in 1973 for the primary purpose of assisting federal government agencies in financing marketable agency-issued and agency-guaranteed obligations. Over the years, the FFB has purchased various kinds of obligations issued or guaranteed by a wide variety of federal agencies. We believe the FFB currently has the statutory authority to purchase participation interests in pools of newly originated government guaranteed FFELP loans as well as senior, triple-A rated securities backed by FFELP loans.

The primary benefit of this solution would be to provide the necessary liquidity for FFELP originators to meet student demand in the coming lending season, and in a method similar to existing market structure and practices. This method would avoid significant risks of disruption and provide for maximum efficiency in meeting student needs this year. Importantly, the FFB would be purchasing interests in or senior securities backed by government guaranteed student loans so the American taxpayer would not be subject to any additional credit risks. We believe that this approach would be a more effective and efficient solution than other alternatives currently being contemplated and could also provide stimulus to the asset-backed market.

2. Term Securities Lending Facility (TSLF)

Another option that would provide some additional liquidity to the market would be to extend the definition of program-eligible collateral of the newly created Term Securities Lending Facility (TSLF) to include triple-A rated student loan ABS, which would allow these securities to be pledged as collateral to borrow from the newly created TSLF or a similar facility. Given the very limited credit risk inherent in triple-A rated government guaranteed and private student loan asset-backed securities (SLABS), we believe this proposal would also appropriately balances managing federal government risk exposure with meeting the urgent need for additional sources of liquidity to help fund student loan originations.

Conclusion

The costs of higher education have escalated substantially over the last decade as colleges and universities have raised tuitions well beyond the pace of inflation. We know that students will continue to need the federal government's assistance in meeting these costs. FFELP has been an extremely successful program, providing hundreds of billions of dollars of financing at a remarkably low cost and high service to 80% of American student loan borrowers.

Unfortunately, reductions in the government guarantee rates and special allowance payments as well as the current high cost of credit in the capital markets have come at a time when demand for education funds has never been greater.

We encourage the federal government to act expeditiously to implement a targeted and near-term set of solutions such as allowing the FFB or the TSLF to provide liquidity in the current credit constrained environment. We believe these actions would help avert a much greater, and potentially more costly, federal intervention later.

I thank you for the opportunity to testify on this important and timely issue today. The ASF and SIFMA look forward to working with you, Mr. Chairman, the Committee, Congress and the Administration to ensure student loans are available to all eligible borrowers who seek financing for their educational expenses.

Testimony of
President Patricia A. McGuire
Trinity Washington University

Before the Senate Banking Committee
April 15, 2008

Regarding the Impact of the Credit Crunch
On the Student Loan Market and College Students

Trinity is one of the remarkable stories of transformation in American higher education. One of the nation's historic Catholic women's colleges, now a comprehensive urban university, Trinity today educates a majority of African American, Latina and other students from economically disadvantaged backgrounds in the District of Columbia and nearby Prince Georges County. After years of struggling with enrollment, our historic undergraduate women's college is now thriving with a new generation of young women from our region who desire an excellent academic education, while working women and men from D.C. and surrounding jurisdictions find Trinity's professional programs to be sources of great success. Scores of local employers seek out our students even when they are still in school, and our graduates gain entrance to some of the finest law, medical and graduate schools.

All of this is now at risk. The credit crisis and its potential impact on student loans could have grave consequences for Trinity and the students we serve. I am testifying here today because Trinity is emblematic of the small, private institutions of this nation --- of which there are hundreds --- who, while thinly capitalized, are providing vitally important educational leadership to at-risk students, which is a great service to our region and nation. Trinity's $10 million endowment marks us as one of those colleges founded by Catholic religious women whose devotion to mission led them to spend more time teaching their students than amassing wealth. It is one of the great ironies of contemporary higher education that small, marginally-resourced private institutions like Trinity now serve proportionately more low income students than many public universities, particularly the flagship state universities. Trinity's median family income is about $30,000, compared to a median family income near $100,000 at Maryland or UVA.

Our students are at grave risk. To supplement the very large tuition support that Trinity provides in unfunded institutional grants (averaging 40% of our tuition price) our students also depend heavily on federal student loans and some private loans to finance their education at Trinity and to support their living expenses while in college. Unlike wealthier families, these students have no fallback position. If their student loans disappear, their college may also be at grave risk. We, too, have no fallback position. Yale, Harvard, Princeton and other immensely wealthy institutions can relieve middle class families of any worries by removing loans entirely from their financial aid mix, using the earnings of their massive endowments to subsidize students

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whose family incomes may be as high as $150,000 per year. My students --- whose families would be delighted to earn $50,000 per year --- cannot have the same financial privileges that Harvard and Yale can extend to their students. Where will my students go to school if their loans disappear? What will Trinity do if our students cannot afford to pay their modest balances on our tuition bills? The credit crisis poses enormous risk for students and colleges both.

Trinity: History and Transformation

Trinity has played a significant role in American history. Founded in 1897 by the Sisters of Notre Dame de Namur to educate women who were barred from admission to the male universities in Washington in those days, Trinity College grew to become the *alma mater* of many notable women of achievement in the public sector, including numerous judges at the federal and local levels, White House staff in several administrations, a governor (Kansas Governor Kathleen Sebelius, Class of 1970), former Congresswoman from Connecticut Barbara Bailey Kennelly, Class of 1958, and the first woman Speaker of the House Nancy Pelosi, Class of 1962.

(May I also note Speaker Pelosi's distinguished classmate Martha Dodd Buonanno, sister of Senator Dodd, whose Trinity roots were clearly established well before he met Martha, since his dear mother Grace Murphy Dodd was a member of our Class of 1929!)

Trinity in 2008 is a remarkably different institution from the historic Catholic women's college of the previous century --- larger, more diverse academically and demographically, and serving a majority of students of color from economically challenged backgrounds. Trinity in 2008 enrolls more District of Columbia residents than any other private university in the nation; nearly half (about 785) of our 1650 degree students are D.C. residents; another one-third hail from Prince Georges County, sharing many of the same economic and demographic characteristics of our D.C. residents. Virtually all of our D.C. residents come from the eastern half of the city, fully a third from east of the Anacostia River in Wards 7 and 8. We are the only university offering a degree program east of the river at THE ARC in southeast Washington.

Trinity helps students to achieve levels of academic success that many previously thought unattainable. Trinity's studies show that during a five year period since 2001, 65% of our D.C. students are either still enrolled or have graduated, a remarkable rate of success in a city where studies show that only 9% of today's 9th graders will finish college[1]. A recent report by the D.C. State Education Office, funded by the Gates Foundation, hailed Trinity's success with D.C. students: "...the District should more proactively encourage increased D.C. student enrollment in colleges with a track record of success in serving low-income and minority students, including

[1] For more on Trinity's success with D.C. students go to http://www.trinitydc.edu/dc/

higher graduation rates...such as Trinity..."[2] Trinity's overall six-year completion rate is about 55%, which is significantly higher for the population we serve than the national average.[3]

Today's Trinity graduates follow in the footsteps of our prior generations when it comes to post-baccalaureate achievement: among recent graduates we have a Jack Kent Cooke Scholar now studying law at Georgetown; a Charles Rangel Fellow preparing to enter the foreign service; and numerous candidates for degrees in medicine, law, policy studies, education and other fields in universities as distinguished as Columbia, Penn, Cornell, the University of Virginia, Georgetown Law and many other great graduate schools. Our recent graduates have also gone on to work in excellent professional positions with many federal agencies and private firms in the Washington region. Because of our strong tradition of internships, nearly 100% of our students are employed by the time of graduation. A recent report on the higher ed website www.insidehighered.com highlighted Trinity's new general education curriculum, illustrating the tremendous faculty commitment that ensures success for our students. This article is attached to this testimony.

Trinity accomplishes all of this without a great deal of fanfare, and without extravagant resources. In testimony I gave in December 2006 before the Senate Finance Committee (see http://www.trinitydc.edu/offices/president/Speeches/2006/120506_Senate_Finance_Testimony.php) I elaborated on the many ways in which Trinity and institutions like us provide great value for college students with only modest resources and careful attention to student economic concerns.

Demographics and Economics

Nearly 90% of Trinity's students today are Black, Hispanic, Asian or international in their immediate family identities, and more than 95% are low income students who receive substantial unfunded tuition discounts in order to attend Trinity --- 40% is our average full-time tuition discount. "Unfunded" means that we do not have endowment subsidizing these "grants"--- this is lost revenue, amounting to more than $4.5 million annually on our $25 million budget. Trinity's endowment is just about $10 million, which means that we do not have the means to support our students if the federally guaranteed student loan programs or the private loan

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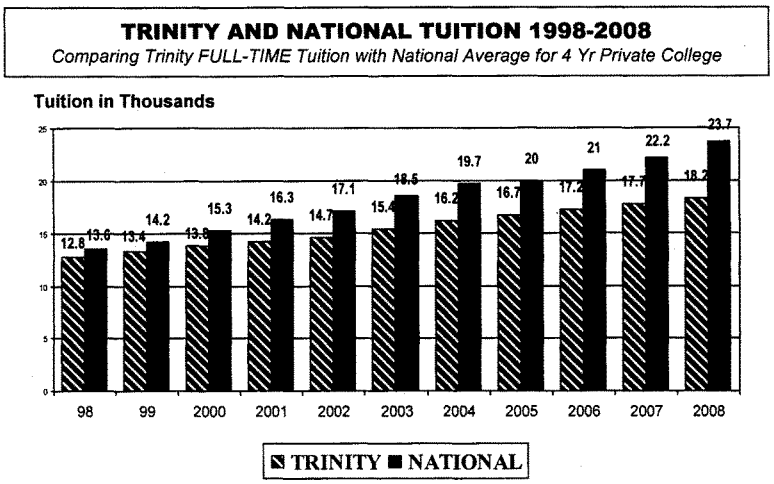
[2] "Doubling the Numbers: a Call for Action for the District of Columbia," D.C. State Education Office, October 2006. Available at http://newsroom.dc.gov/show.aspx/agency/seo/section/2/release/9956

[3] Many of the students who do not complete at Trinity actually complete their degrees at other institutions, but the current national method for calculating graduation rates does not include students who transfer out and complete elsewhere. Moreover, some students who stop out actually do come back to complete degrees later on, in our adult studies programs, but students who take more than six years to complete are also left out of the current methodology for calculating completion. In particular, many women who start degrees when they are teenagers stop out to have families or care for sick relatives or attend to the demands of work; they return to college in their 30's and 40's to finish those long-desired degrees. In other forums, I have advocated for a change in the view of degree completion to capture these persistent undergraduates whose circuitous route to degrees is heroic and deserves recognition in our national data system. Note as well that, nationally, nearly 75% of all undergraduate students are now "non-traditional" by age or work circumstances or de facto independence from parents. Fewer than 25% of all undergraduates are "traditional" in terms of being on-campus residents with two parents who are paying the college bills. Lenders who threaten to use "dropout rates" or other statistically flawed methods need to take a careful look at the real data and trends behind the published information.

programs are jeopardized. 62% of Trinity students receive Pell Grants, another indicator of the critical economic challenges our students face.

Tuition and Financial Aid

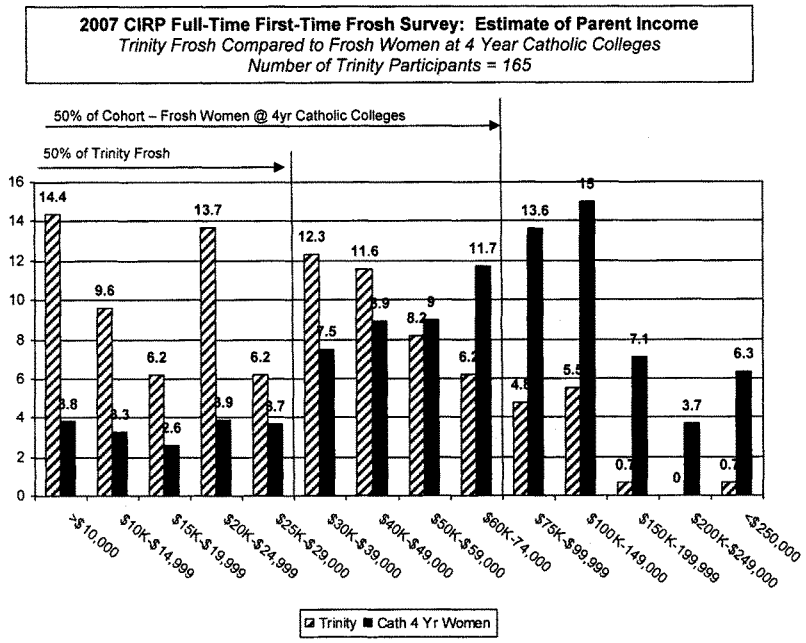
Trinity's full-time tuition is $18,250 in 2007-2008 (in 2008-2009, tuition will go up 3% to $18,800), but I don't know of any students who actually pay that amount. Trinity makes every effort to keep our annual tuition increases very modest, just about 3%, since we know our students have large financial burdens. Trinity's tuition today is just 77% of the median national tuition for private four-year colleges ($23,700 in 2007-2008). The chart below showing the difference between Trinity's price increases and national private college tuitions illustrates the fact that Trinity's modest tuition pricing policy has provided a sizeable amount of additional price support to students that is in addition to the formal 40% average discount that nearly 100% of our full-time students receive.



Trinity provides similarly price-conscious tuition rates for our part-time and adult students in professional and graduate programs. We estimate the total cost of attendance at Trinity this year to be $26,900 (in 2008-2009 we estimate the total cost will be $27,700) with housing and food costs added, either on-campus or off-campus. For full-time undergraduates, after the Trinity discount, the Pell Grants, the D.C. Tuition Assistance Grants and other financial aid, the typical full-time Trinity student pays about $2,000 or less out-of-pocket for remaining tuition balance and related non-housing expenses like books or transportation. That's still a great struggle for many of our students. Book prices alone can break the back of even middle class students, to say nothing of students hailing from Wards 7 and 8 in D.C. --- a $160 economics or biology textbook has sadly become the norm, and even though we work with faculty to find alternatives, books

remain the bedrock of higher learning and students need to acquire their own academic materials over time. In the same way, having a personal computer today is essential for academic work, but many of our students cannot imagine spending $500 or more to purchase their own computer; we provide as much space as we can afford to offer in computer labs.

In order to afford these essentials, most of our students are working at least 30-40 hours a week, even as full-time 18 year-old freshmen, in order to achieve their dream of a college degree at Trinity. The majority of these students have virtually no "expected family contribution" when financial aid calculations are done, and they are largely independent students even though they are of traditional college age. Many of these students also contribute to the support of their families, including, in some cases, their own children. But their desire for a college education is so strong that they are willing to work hard and make many sacrifices in order to stay in school.



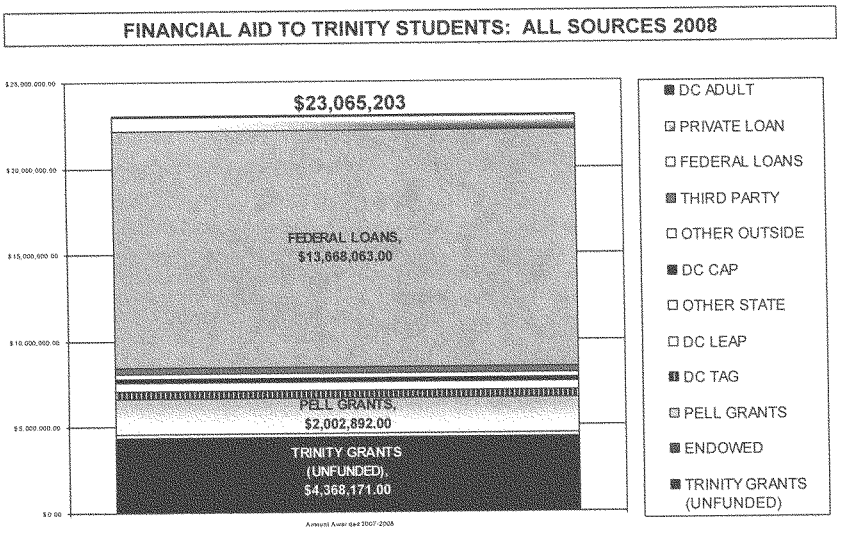
The chart above is illustrative of the economic challenges of Trinity students. This data comes from the Freshman Survey of the Cooperative Institutional Research Program (CIRP) administered every year to first year students since 1968. Trinity's comparison cohort is women at 4-year Catholic colleges. For Trinity freshmen in the Fall of 2007, 50% reported estimated family incomes of less than $30,000. Compare that to the cohort group, where 50% reported estimated family income of less than $75,000.

The Vital Importance of Federal Loans

The federally guaranteed loan program is essential to ensure that Trinity students, and students like them, can stay in school, focus on their academics, and earn their degrees. At a time when there's so much national rhetoric about the cost of higher education and the squeeze on low income students, in particular, the credit crisis and the threats to the loan programs could be catastrophic not only for individual students but for the future economic productivity of our nation.

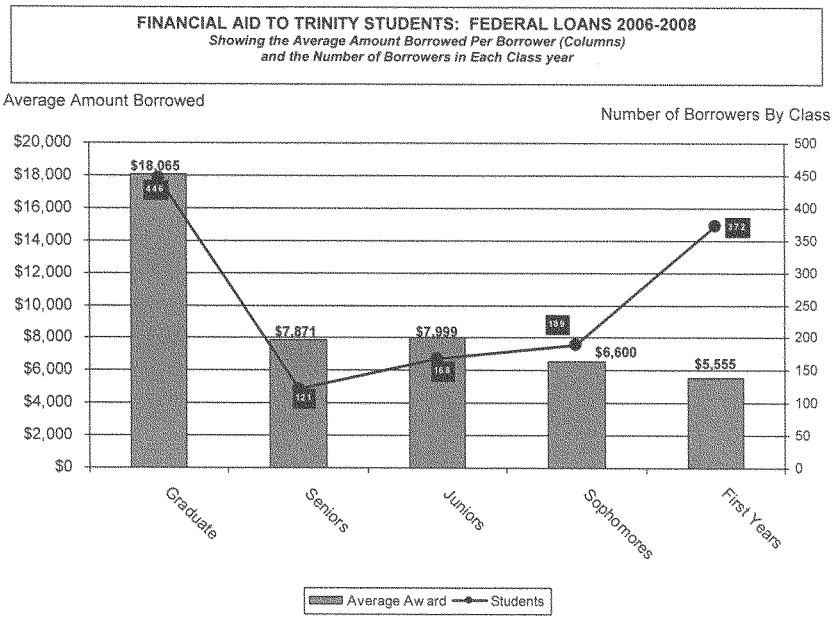
Our students at Trinity clearly need the federal loan program to help them cover the remaining tuition costs that Trinity and other grants cannot subsidize, as well as the additional costs of attendance beyond tuition, including support for housing and food, as well as books and transportation. Our experience shows that we refund about 35% of the total loan volume back to our students, and these refunds make it possible for students to pay for their books and living expenses while enrolled in school.

To understand the significance of the federally guaranteed loan programs at Trinity, here is a snapshot of our total financial aid volume in 2007-2008:



To put those numbers in perspective: Trinity's operating budget in Fiscal 09 will be just about $25 million, and we expect our tuition revenues to be fairly similar to this year --- about $19 million in net tuition after we subtract the discount. So, Trinity's budget is about 76% dependent upon tuition revenues, 80% dependent on student tuition and fees when we add in room and board fees. Because student loans are the largest form of financial support our students receive, any weakness in their ability to secure loans will also impact Trinity's bottom line quite severely. Our $10 million endowment could not possibly backstop any erosion in student loans, particularly in light of our already-substantial discounts.

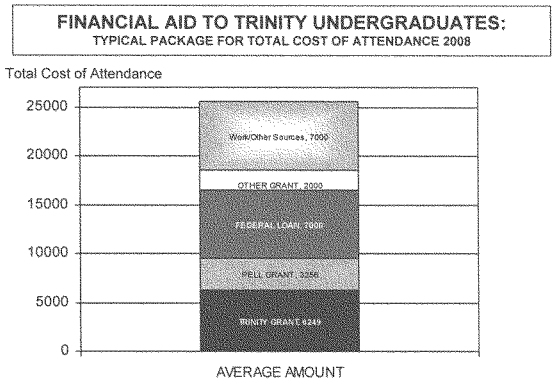
The chart below shows how the $13.6 million in federal loans works by student by grade level:



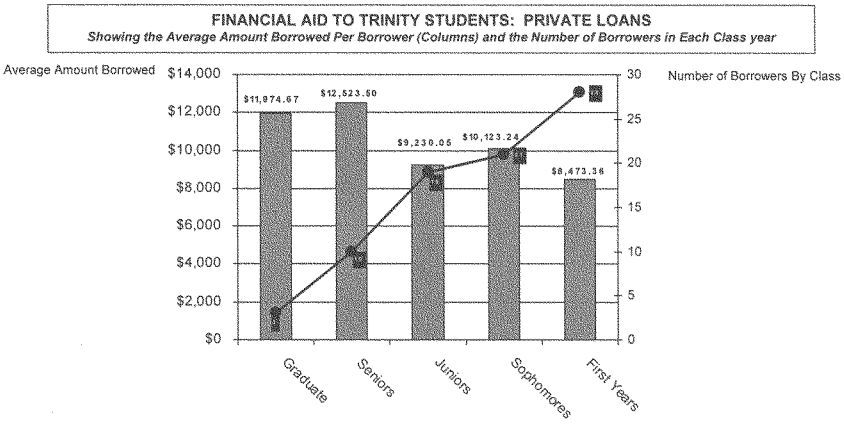
For the nearly 1300 students receiving loans reflected on the above chart, any reduction in their ability to borrow could be catastrophic for their academic careers and personal life goals. Graduate students, who can borrow very substantial sums, are not eligible for grants, so they need the loans to support the full tuition price. The 372 first year students could not possibly replace $5,555 in loans with other aid sources; Trinity already provides those same students an average Trinity grant of $6,550, and 78% of that student group also receives Pell Grants averaging $3,402.

I should also point out that even with such a large loan volume, Trinity's default rate is just about 3.2%, which is a remarkable achievement that indicates how seriously our students take their obligations to repay their student loans.

The typical financial aid package for a full-time Trinity undergraduate looks like this:



While the vast majority of Trinity students participate in the federally guaranteed student loan program (FFELP), a small number of Trinity students are also dependent upon private alternative loans to help finance a portion of their higher education. We currently have 81 students, including 78 undergraduates, who receive nearly $800,000 in private loans. The illustration below shows the average private loan for these students by class year. This group is the most seriously at-risk at present for devastation of their college plans by the collapse of the private loan market.



CONCLUSION

Higher education is the engine that drives the Knowledge Economy. For this nation, promoting access to higher education has been a firm national policy since the GI Bill in 1944. Successor legislation expanded the benefits of that landmark law to millions of students who might not have gone to college without the benefit of federal aid.

I know full well the importance of financial aid, particularly the federal student loan programs. I could not have attended Trinity College without a generous scholarship from a benefactor I never met, and I would not have been able to afford my law degree at Georgetown without federal student loans. Looking back, I am still amazed at the ways in which that generous benefactor and those progressive loan programs shaped my professional and personal life.

When I see my students racing to class each day at Trinity, struggling with their Shakespeare papers and pondering their history textbooks, learning to conduct public opinion polls or chemistry experiments, I know that great careers and fulfilled lives are on their horizons because of the opportunities we have been able to extend to these students at Trinity. Particularly for the young women from the District of Columbia for whom Trinity offers so many advantages that were not part of their previous educational experience, the pride, self-confidence and academic skills that they acquire at Trinity are truly transformative. When I recently listened to a student explain with excitement how she finally understood algebra, when I saw her joy as she related her parents' disbelief that she is now earning at least B's on her math exams, I know that we must find every means to sustain our mission.

Federal student loans are essential to fulfilling the promise of higher education for the students we serve at Trinity, who are not so very different from millions of American college students. The return they will make to this nation is incalculable --- if they are able to persist in school and finish their degrees. Any interruption of student loans will be a great loss not only for our students and our institutions, but also for our nation.

INSIDE HIGHER ED
insidehighered.com

April 4, 2008

The Foundations of General Education

Students in Minerva San Juan's philosophy class at Trinity.

Elizabeth Redden

At one point during class Minerva San Juan stopped short. A student in the front row had successfully volunteered the link — and leap — between an assumption in an article and an inference drawn from it, and the professor wanted a second to savor, even celebrate, the occasion.

"That moment of abstraction is what they're not used to doing in high school at all," San Juan explains after class, Philosophy 103: Reasoning and Argumentation, in a hallway of the old, stately Main Hall at Trinity College, in Washington, D.C. The building dates to the college's opening in 1900 and its heritage through much of the 20th century as an elite Catholic women's college, a sister to Georgetown University across town. Under pressure to change after suffering intense enrollment declines in the 1970s and '80s wrought (in part) by expanded coeducation, today Trinity is an institution transformed, with its largest freshman class this fall since 1967 — and a very different class at that. Nearly half its students are D.C. residents, more than 85 percent are black and Hispanic, and 62 percent receive federal Pell Grants (a proxy for low-income status).

"Trinity has gone through this radical and exciting transformation and while I think our faculty have done an amazing job of developing pedagogies to reach out and be successful with this new student body, the curriculum hadn't kept pace," says Elizabeth Child, dean of Trinity's College of Arts and Sciences. This fall, the 631-student women's undergraduate college introduced a revamped general education curriculum, built on the bedrock of first-year classes emphasizing "foundational skills" — critical reading, written communication, oral communication, critical reasoning, and quantitative reasoning.

"I think it would be fair to say that the driving impetus behind our discussions and the way that we crafted this curriculum was that, for the student body that we serve, the student demographic that we serve, there are a lot of discussions about their deficiencies," Child says. So-called urban learners "tend to come from big urban public high schools where they've been educated in chaotic and unsatisfactory ways. They have lots of educational deficiencies. They know that; there's a lot of press about that, about the Washington, D.C. high school systems."

"What we wanted to do was craft a curriculum that speaks to and takes advantage of the amazing assets of these students. In particular, we wanted to recognize the resilience of our students and the persistence of our students, the kind of survival skills that they have learned in order to get to the point that they would even aspire to go to college" — while, at the same time, Child says, recognizing that many students come in unprepared for college-level work in some subjects.

"There were things which were implicit in the old curriculum which now we have simply made explicit. Instead of expecting our students to infer how you read critical theory by simply giving them examples and saying 'Read this, and come in and talk about this,' we're now much more explicit. 'Here's the reading that you're going to need to be able to do. Here are some strategies for doing that reading successfully,' " says Child. The new curriculum requires students to take classes in each of the five foundational areas, with an emphasis on delivering skills instruction through the disciplines. On a recent Wednesday in San Juan's philosophy class — which fulfills the critical reasoning requirement — San Juan, an associate professor, led students through an analysis of Baruch Brody's article on "Fetal Humanity and Brain Function," beginning with the article's purpose, the assumptions (and inferences!), information presented, etc., and ending with a set of questions about "How convincing is the article?"

"In [most other] classes, you read an article, you have to say what it's about, but you don't go into what is an argument," says Ana Schwartz, a freshman from the Maryland suburbs.

"Is it accurate, is it biased, in one way or another — the questions you should be asking but I don't think we ever thought about it in a formulaic way," adds Morgan Kellman, also a freshman from Maryland.

"You can use the formula basically for everything that you read," says Schwartz. "If I hadn't had this class, I probably would have been having a harder time."

The 'Urban Learner'

As students deconstruct and reconstruct articles and their arguments, faculty members at Trinity are doing the same for the term "urban learner," typically used in K-12 settings — evaluating the term's usefulness for college students, looking for biases and ultimately reframing it as a starting point for many of the conversations surrounding the new general education curriculum.

"We find the term a little limiting, quite frankly, but in the absence of anything else, we're using it as a springboard to craft a new agenda for higher ed," says Diane Forbes-Berthoud, the communication department chair. She and Carlota Ocampo, an associate professor of psychology and associate dean for the first-year experience at Trinity, are co-presenting a paper on their research of urban learners at the Caribbean Studies Association Conference in Colombia in May. In their surveys of what faculty think about the term, "The responses are mixed," Forbes-Berthoud says. "Some people concur with the current definitions, which are persons who are at-risk, low-income.... Others have found it to be very limiting; some went so far to say racist. Some thought there was little difference between Trinity students and others." "In many ways, we're challenging this discourse."

Data-Driven

An emphasis on developing the tools to build upon and challenge the dominant discourse is at the foundation of the new Trinity curriculum. "It's important that you look for inferences that do not seem to be well-founded in data," Saundra Oyewole, a professor of biology, tells students during her class on Critical Thinking About Disease. Between calculating body mass indexes (with one student ending up quite surprised and a bit disturbed to find out that using the index, her mother would be obese), Oyewole discusses the need to rigorously evaluate data and how it's presented, to examine the scale used on any graph, and to consider the sample size.

Data on the success of Trinity's curricular changes are only preliminary at this point. But faculty and administrators said they were pleased with what they describe as promising early results in critical reading and math — which, also new this fall, are taught at the lowest levels by specialists who offer

extra lab sessions. Child, the dean of the college, cites data showing that among students who placed into the developmental math track this fall, those who completed the course with a C- or better scored an average of 17.1 on the post-test — significant because 17 is the benchmark for placement into college-level math. (Pass rates in two developmental math courses were 65 and 45 percent, respectively.)

And, in reading, where half the 45 students placed in a developmental course passed and half didn't, about 90 percent showed gains on their post-test scores, and half of those students improved their scores by more than 50 percent, Child says.

In terms of other support services, the Academic Services Center has moved from a somewhat "tucked away" corner of Main Hall's third floor known, tellingly, as "the maze," to an airy, open space in the library where stacks of periodicals used to live. Staff report increases in foot traffic — with use of the Writing Center up 200 to 300 percent this year.

The university is also in the midst of evaluating the cost of the curricular changes through a Lumina Foundation-funded project. "On a national level," says Cristina Parsons, an associate professor of economics and formerly an associate dean, "the conversation regarding better access for all students has really revolved around the explicit cost to the student of an education" ($18,250 in tuition at Trinity this year, with an average discount rate of 40 percent). "We want to have more universal access to higher education, so we've pretty much focused on how to best fund that education for students with modest means. But the other side of that question is these programs are staggeringly expensive to deliver."

At the same time, faculty describe the new curriculum as just the most recent, and logical, step in the institution's evolution. "A lot of this is not rocket science. It's just that we never did it before," says Ocampo, the associate dean for the first-year experience.

"What the founder of this place said," San Juan added, "is 'teach them what they need to know.'"

Hearing of the Senate Committee on Banking, Housing, and Urban Affairs
April 15, 2008

Testimony of Sarah Flanagan
Vice President for Policy Development
National Association of Independent Colleges and Universities
Washington, D.C.

Mr. Chairman and Members of the Banking Committee –

Thank you for holding this important hearing today. My name is Sarah Flanagan and I am Vice President for Policy Development at the National Association of Independent Colleges and Universities (NAICU). Our association represents 953 of America's private colleges – from the Ivy League to women's colleges to historically black colleges and universities to a myriad of faith-based institutions representing the full diversity of our nation's people, history, and collective intellectual traditions.

I am both honored and proud to share this panel today with Pat McGuire, president of Trinity Washington University, not only because I so admire her and her institution, but because Trinity is the perfect example of the kind of institution that composes our association's membership. Trinity is small, it is lean, it is personal, it is innovative, and it is a jewel of diversity, opportunity, and hope. When they hear the term "private college," Americans most often think of the acknowledged higher education superstars such as Harvard, Yale, and Princeton. However, Trinity is much more typical of the nation's 1,600 private colleges – in wealth, in purpose, and in size.

For example, if you were to remove the 45 private colleges with endowments above a billion dollars from consideration, the remaining 1,555 have a median endowment of $14 million. Most private colleges rely heavily on tuition to remain financially sound, doing the best they can to offer a high quality college education to all students, regardless of their economic means. It may surprise you to know that, while private colleges are misperceived by many as serving only the affluent, our institutions in fact educate the same proportion of low-income, high-risk, and minority students as four-year public colleges and universities.

Also defying conventional wisdom, many families find that when their aid offers arrive from private colleges, the net tuition they actually will pay is comparable to the cost of their local public college. This is because private colleges provide a huge amount of grant aid from their own funds.

Still, not all private colleges can make up the difference in cost for every family. This means that some students are unable to cover tuition and fees through the federal student loan programs. This is not surprising. The federal government has limited student borrowing under the federal programs, both to keep students from acquiring too much debt at a young age and because of federal budget constraints. When the federal student loan programs began in 1965, freshmen could borrow $2,500. It wasn't until 1981 that limit was increased – and that was only to $2,625 to cover a new loan origination fee.

The current academic year marks the first time since 1965 that freshman loan limits have truly been increased, to $3,500. Upperclass students have higher limits, but the maximum for juniors and seniors is capped at $5,500. In 2007-08, new federal student loans totaled $80 billion – $15 billion with direct federal capital and the rest through the bank-based federal student loan programs.

Fortunately, there are additional sources of federal loans. Creditworthy parents of dependent undergraduates can borrow up to the full cost of attendance in the federal PLUS loan program. And adult students, or dependent students whose parents can't meet the PLUS credit test, can borrow an additional $4-5,000 in federal loans. For the few students attending colleges with sufficient Perkins loan funding (formally called National Defense Student Loans), they can help meet their financial needs through very low cost loans under that program. But Perkins funding is rapidly drying up under the administration's continuing attempts to eliminate the program, and repeated cuts by Congress in the program's funding.

The net effect of these limits on the federal student loan programs has been a burgeoning private student loan market. Reliable data on the private student loan market is hard to find. However, the College Board estimates that over the past ten years private student loans have grown to more than $17 billion, from $1.6 billion in 1996.

Who are these borrowers? For the most part, students at private, non-profit colleges are relying on these loans as a last resort. They have hit their borrowing limits in the federal programs, the

school's financial aid fund has been tapped dry, and they need additional funds to get to graduation. Private loans have become a limited and imperfect, but essential access tool for these students.

The NAICU Survey

As the pressures on financial markets reached the front pages, NAICU thought it would be wise to survey our members, to determine how the larger market problems might affect student lending. Like these other markets, student lending has changed a great deal in the past decade. As with other types of consumer loans, the financing markets supporting student loans has become turbulent and much more expensive, as a result of the well-publicized failure of the auction rate securities market. Our survey was an attempt to get a quick snapshot of current and potential effects, if any, of all this economic turmoil on our colleges and their students.

NAICU surveyed its 953 member institutions between March 3 and 14. A total of 315 institutions responded, for an overall response rate of approximately 33 percent. A copy of our survey and details of our findings are attached to my testimony. We were relieved to find that most schools are still able to secure commitments from lenders to provide their students loans. However, there are some warning signs. Let me highlight a few of our key findings.

Of the nearly nine out of ten respondents that participate in FFELP loans, well over half said that one or more of their lenders are no longer providing FFELP loans. So far, this gap is being filled by other banks.

On the private student loan side, the signs are a bit more troubling – especially in the percentage of schools relying on private loans who told us that these loans were important to their institution's financial stability.

Of the close to 300 respondents participating in private-label loans, 60 percent said that private student loan borrowing was either very important or critically important to their institution's financial health. The rest viewed private-label loans as somewhat important, not very important, or not at all important.

Well over half of the responding institutions reported receiving information from "preferred" lenders about the lenders' ability to make non-federal private label loans for the 2008-09 academic year. Almost half said that one or more of their lenders are tightening credit requirements for private label loans, and over 40 percent had been told that one or more of their lenders would no longer be providing private label loans. Also, 30 percent of this group had been told that one or more of their lenders are reducing or eliminating borrower benefits, and 20 percent reported lenders saying that they are increasing interest rates.

Timing Is Everything

Since we closed this survey on March 14, storm clouds have continued to gather. Following up on our survey findings that private non-federal lenders were putting more credit requirements into place, one state surveyed its members whose students rely on these loans to see how many of the students could meet the new credit requirements. The news was not good. Several colleges fear that their financial stability could be at risk, and nearly every college expects to lose some students if something isn't done to ensure supplemental loan funding for students with the greatest financial need.

Tightening credit requirements is not all bad – particularly if an institution's default rates on federal loans give evidence that students may not be able to handle additional debt. But losing supplemental loan funding for all students at all colleges could pose an insurmountable barrier for many worthy students at worthy colleges.

This month begins a critical time in student lending. The high season of the college loan business is about to begin. On the first of this month, the last batch of colleges mailed out their college acceptance letters to millions of American students. This week, families of accepted students are opening letters that detail what the college will provide in financial aid. Families have only between now and May 1 – when deposits are due – to make their final choices. As we sit here today, families across the nation are sitting down, comparing options and making these tough decisions, factoring in the types and amounts of student loans they have been offered.

From May until late August, the loan process will be in high gear. Colleges will certify to the lender the student chooses that the student is actually enrolling, the amount and type of loan aid they have requested, and their eligibility for that aid. Loan applications and promissory notes will fly between families, colleges, and lenders as the fall semester approaches.

This year, though, there is an additional overlay to this annually stressful period for all parties. Many student lenders historically have relied on the auction rates securities market for funding. Today, though, our institutions are concerned that if lenders can't rely on this traditional source of funds, and then can't lock in reliable alternative funding for both federal and non-federal student loans, the lenders may find themselves without the capital demanded for the peak processing season. Simply put, many of our institutions are anxious that the financing markets might worsen between now and September, and that in the in the middle of this peak processing season, their lenders might curtail or stop making student loans.

Let me emphasize that we are not in a crisis. We know of many colleges that have lost lenders, but all are working successfully to find new lenders to fill the gap. However, as more and more lenders drop out, colleges are increasingly concerned about overall market liquidity. Adding to this worry are problems many of them are facing in refinancing their own institutional bond debt, or in the increased cost of this debt.

The students graduating from high school in the coming weeks, and planning on college in the coming months, don't have the option of waiting for the market to improve. The same can be

said of those returning college students whose parents qualified for a PLUS loan last year, but because of the family's difficult financial situation this year may have to go to last-resort private lending. They – and we – wish there were no need for any family to borrow for a college education. However, in limited circumstances when private lending is necessary, the only thing more expensive than taking out a private student loan is not finishing college at all.

Let me add a final note of caution. Some players in the private student loan market have not simply provided last-resort loans for students likely to succeed, but have engaged in predatory direct-to-consumer lending practices. That is why a second piece of legislation this committee has been working on, and is now in conference as part of the Higher Education Act reauthorization, is also important. The bipartisan "Private Student Loan Improvement and Transparency Act" creates new protections for students that we enthusiastically support. The bill promotes responsible borrowing by effectively eliminating direct-to-consumer educational loans, making even private educational loans pass through a college financial aid office to ensure that students first borrow through less expensive federal loans, and that they are not borrowing for unnecessary luxuries. We thank this committee for its work on this legislation, and believe it essential to add these basic consumer protections to the private student loan system.

The education committees in both the House and Senate are working on contingency plans to secure liquidity in the federal student loan programs. They are doing this, first, by increasing the current authority of the Department of Education to allow it to act as a secondary market for bank-based loans. Second, they are modifying the lender of last resort program to make it better

able to respond to the current market situation. Finally, they are providing some modest increases in the federal student loan program loan limits.

Still, at the end of the day, we will have some students that – for their own good reasons – will need to borrow in the private market to complete their education, or to enter the college that best meets their educational needs. That is why we hope you will consider taking steps to ensure that there is also liquidity in the private student loan market for those who need to borrow, and for whom private borrowing is appropriate.

Wisely used, student loans are good loans – and not just because of the return on such an investment that we realize as a nation. Student loans also are a good financial investment. This is nothing short of amazing and, in fact, counterintuitive. Traditional students come to college with little or no credit history. Those that need to borrow the most are the poorest. In purely economic terms, this sounds like a high risk portfolio.

However, the numbers show that the opposite holds true. Private colleges and universities in particular have a default rate in the federal student loan programs of 2.4 percent, compared to the national default rate of 4.6 percent. This is a proud record for a loan program in which the collateral is simply an improved mind – not a car or a boat or a home that can be reclaimed and resold.

Such success is a remarkable tribute to the diverse, flexible, engaged, and transformative nature of our nation's higher education system. It also is a tribute to the American spirit of individualism and personal achievement. Student by student, people from all walks of life pore though the books, trudge to the classes, and labor over the papers that somehow make each one a different person in the end – someone who can serve as an engaged citizen, build a career, contribute productively to our nation's economy, and ultimately repay the student loan that made all of this possible.

Mr. Chairman and members of the committee, we realize the huge challenges you face as you work to protect our economy from a crisis in the housing market. However, as you look at fixes for that sector of the economy, we ask you to also remember the nation's homes of our minds, the enterprises that drive our knowledge-based economy – our colleges and the students they serve.

We hope we have no student loan liquidity crisis. Indeed, one may not occur. However, your early attention to the possibility of this emerging challenge will assure that our colleges and their students remain able to perform their essential role in our society.

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NAICU Survey on the Impact of the Credit Crunch on Student Loans at Independent Colleges and Universities

Between March 3, 2008 and March 14, 2008, NAICU surveyed its 952 members to gather information on how the current credit crunch is affecting student loans, specifically FFELP and private-label loans. Data was collected through an online survey (attached at the end of the report). Below is a snapshot of responses[a].

Context: Responding Institutions

- Of NAICU's members, 315 institutions responded to the survey (response rate: 33.1 %)
- Eighty-two percent of the institutions are considered small sized institutions, which have an enrollment of 5,000 students or less.
- Ninety-eight percent are four-or-more-year institutions.
- Responding institutions came from all parts of the country: the South (31.1%), Midwest (30.2), Atlantic (29.8%), and West (8.9%).
- In terms of Carnegie Classification, the responding institutions broke out as:

Carnegie Classification	Percent Responded to the Survey	Percent Responded of NAICU Membership
Research/Doctoral	12.4	42.4
Masters	31.4	35.1
Baccalaureate	40.3	33.2
Associates	2.5	26.7
Special Focus	13.3	22.6

- The responding institutions had the following endowments levels:

Endowment	Percent	Frequency
Less than 1 million	6.3	19
$1M - $49,999,999	54.3	165
$50M - $99,999,999	12.5	38
$100M - $224,999,999	11.2	34
$225M - $449,999,999	6.9	21
$500M or more	8.9	27
Total	100.0	304

[a] Analyses are based on those that responded to a survey question.

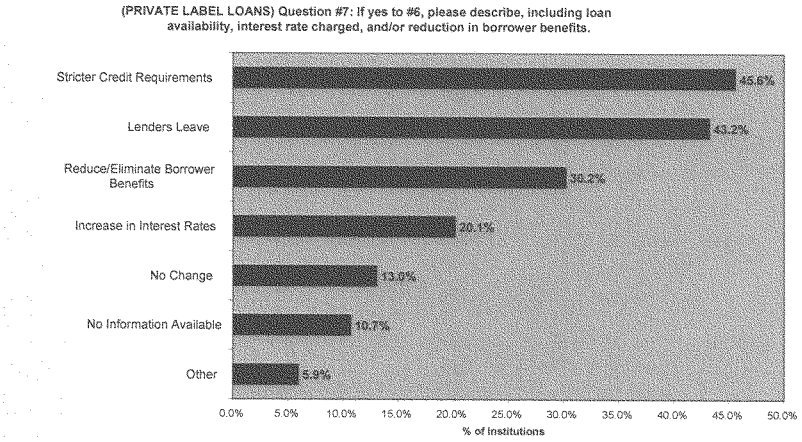
Lastly, a large proportion of respondents participate in both FFELP loans (87.9%) and non-federal private label student loans (76.2%). Few (12.4%) responding institutions participate in the William Ford Direct Loan Program[b].

I. Private Label Loans Findings:

Question #6: If you participate in non-federal student loans, have you received any information from lenders as to their ability to make such loans in AY 08-09?	Percent	Frequency
Yes	61.3	176
No	38.7	111
Total	100.0	287

Of the institutions who responded to Question 6, 61.3 percent reported that they received information from their lenders as to their ability to offer non-federal private-label loans for Academic Year (AY) 2008-09 (Question 6: If you participate in non-federal student loans, have you received any information from lenders as to their ability to make such loans in AY 08-09).

The following graph shows what institutions have heard from their private-loan lenders, which includes loan availability and/or reduction in benefits (Question 7 on the survey):



[b] Approximately 16 percent of all private, not-for-profit institutions participate in the Direct Loan Program for the FY2007-08.

Institutions are also reporting that lenders are leaving the business of lending private student loans (43.2%). However, if lenders are staying in the business, 45.6 percent of institutions report that lenders are imposing stricter credit requirements on students (e.g., requiring co-signers, increasing the qualifying credit scores) as well as reducing or eliminating borrower benefits (30.2%), or increasing the interest rate (20.1%).

Below are typical quotes from our institutions about lenders leaving and changing their loan terms:

> "We have heard from some lenders that interest rates will increase and the approval rates will be much lower. One lender has told us that 72 percent of our students who applied for their alternative loan last year will not be approved without a co-signer for the 2008-2009 year." –small, New England college

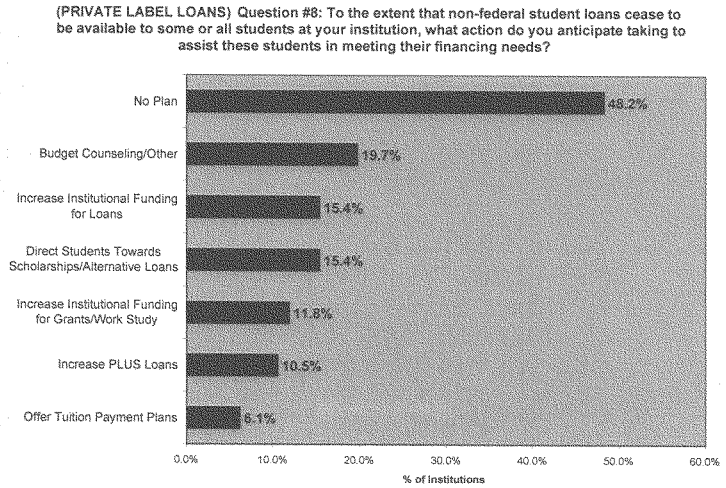
> "Access to private loan funding is our main concern at our college. In the past, students had access to a credit-ready private loan program (no cosigner required, zero credit is considered good credit). Many students took advantage of this program in the past. We have been told that there may be little to no funding for this private loan program in the future (mainly, for the 2008/09 academic year). Knowing the number of students who utilize this loan, we think that may create an access problem with the possible elimination of this private loan program. Many students do not meet the credit/income requirements for many private loans, and they may not have an able or willing cosigner. These situations are the ones in which the credit-ready private loan program has made access to a private education possible for a number of our students." –small, Midwest college

> "Almost all of our private loan lenders have changed their borrower benefits. Their credit acceptance policies, and/or their interest rate options. We have been informed that access to private loans may be limited with increased rates passed on to the student." –small, Midwest college

> "Required FICO score has been increased. Fewer loans to at-risk clients will be made." –small, Southeast college

Alternative Plans to Private Label Loans

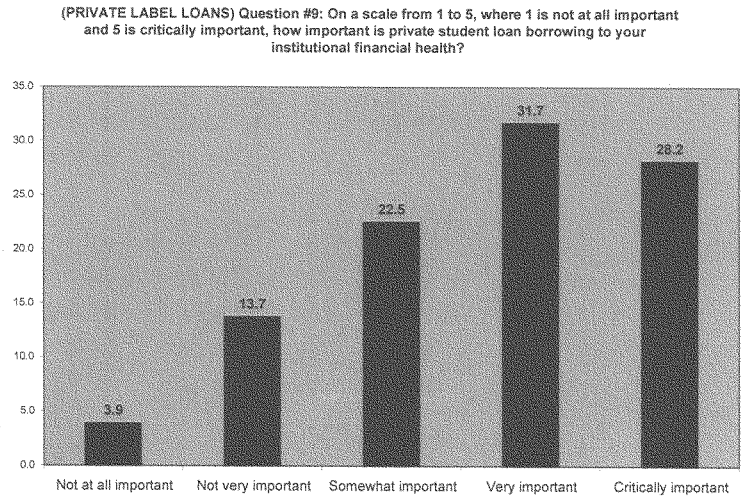
We also asked what action(s) institutions would take if private student loans were no longer available to some or all of their students to meet their financial needs:



Nearly half (48.2%) of the 228 institutions that answered the question "to the extent that non-federal student loans cease to be available to some or all students at your institution, what action do you anticipate taking to assist these students in meeting their financing needs?" reported that they did not have a plan. However, 19.7 percent of the institutions said that they would offer students budget counseling or personal finance education.

Importance of Private Label Loans

The following chart asked our respondents how important are private student loans to their institutional financial health.



Combining the categories "very important" and "critically important", 59.9 percent of institutions that answered the question "how important is private student loan borrowing to your institutional financial health?" report that private loans are essential.

The final private-loan question asked was Question 10 (To the best of your ability, please estimate what percentage of your students takes out private loans, and what the average private loan debt per student is upon their leaving the institution. Enter percentage and dollar amount). Respondents reported that an average of 20.5 percent of their students take out private loans. Students leave with an average private-loan debt of $18,868.

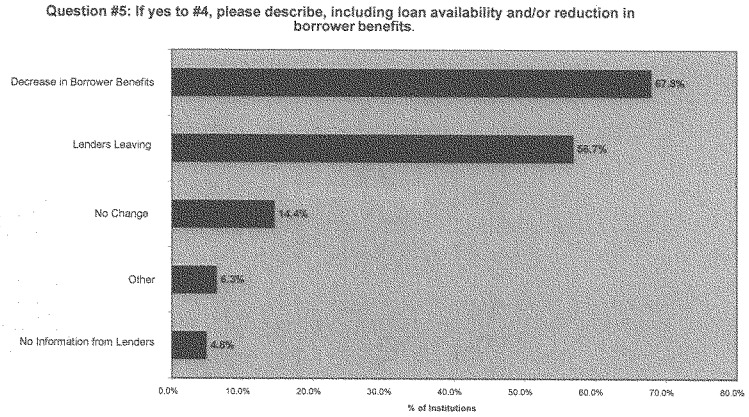
II. FFELP Findings

(Note: When Congress reduced FFELP subsidies in 2007 to increase funding for Pell Grants and other student aid programs, cuts in borrower benefits were widely anticipated, and are not necessarily directly attributable to the current credit crunch.)

NAICU National Association of Independent Colleges and Universities

Question #4: If you participate in FFELP, have you received any information from lenders as to their ability to make FFELP loans for AY 08-09?	Percent	Frequency
Yes	75.6	211
No	24.4	68
Total	100.0	279

Of the institutions who responded to Question #4, 75.6 percent reported that they received information from their lenders as to their ability to make FFELP loans for Academic Year (AY) 2008-09. The following graph shows what institutions have heard from their FFELP lenders, which includes loan availability and/or reduction in benefits:



While the most noticeable finding in this graph is the substantial decrease in borrower benefits (i.e., paying of fees and back-end benefits), another important finding from this graph is that nearly 60 percent of our institutions have found at least some of their FFELP lenders are no longer providing FFELP loans.

The following quotes are typical responses from our institutions.

> "Two of our three preferred lenders that we had planned to utilize have dropped out of FFELP in the past few weeks. We have seen every single lender cut either front end or back end benefits or even both front and back end benefits." –Small, Midwest college

"We have received information that several lenders are suspending their participation in the FFELP program. There is a concern regarding the ability of state agencies to securitize student loan debt and issue bonds. Student loan providers are having difficulty raising money to lend to students. Those that are successful are paying higher interest rates. We are also seeing a movement away from providing students with back-end borrower benefits as well as holding students responsible for the origination and default fees. The costs to students are clearly increasing." –Large, Midwest university

"Quite a few lenders ... have withdrawn from making new loans and/or servicing existing loans; borrower benefits are pretty much non-existent anymore; much higher minimum limits for consolidating loans." –small, Midwest college

"Some lenders have quit making FFLEP loans...However many have stated they will not pay the origination fee, the loan default fee, nor offer back-end borrower benefits. As a result many of our students will pay an additional 3 percent in fees and lose benefits which average 3.5 percent during repayment." –small, Southwest college

* SURVEY INSTRUMENT *

NAICU Survey on the Impact of the "Credit Crunch" on Student Loans at Independent Colleges and Universities

As you are aware, the turmoil in the capital markets is causing much speculation on the availability of capital for student loans. NAICU is monitoring the situation, and is conferring with Congress and officials at the Department of Education about any possible federal action in this area.

This survey is intended to gather institution-specific information on the issue from our members. It will remain open through Friday, March 14, 2008; however, given that members of Congress are eagerly awaiting what we learn through this survey, **please respond by Friday, March 7, if at all possible**. Please complete and return the survey, even if your institution is not currently experiencing problems in these areas.

We would appreciate your letting NAICU know about your institution's student lending situation by answering the following questions. NAICU will analyze and aggregate the responses – without identifying individual institutions – so that we can inform the appropriate policy makers should we see a national pattern emerging.

We suggest you complete the survey using the on-line form. If that is impractical for some reason, you may complete this printed version of the survey (using additional sheets for comments if necessary), then mail or fax it to "Debt and Loan Survey" at NAICU, 1025 Connecticut Ave., N.W., Suite 700, Washington, D.C. 20036-5405; fax, (202) 835-0003.

For questions about this survey, contact Frank Balz, Vice President for Research and Policy Analysis at NAICU (frank@naicu.edu, 202-785-8866).

Thank you in advance for your invaluable assistance as we address these emerging issues.

NAICU National Association of Independent Colleges and Universities

1. Institution Name: _____

2. State: _____

3. In which of the following does your institution participate? (Check all that apply):

A. Federal Family Education Loan Program (FFELP)
B. William Ford Direct Loan Program
C. Non-federal private label student loans (i.e., student loans other than FFELP, Direct, Perkins, etc.)

4. If you participate in FFELP, have you received any information from lenders as to their ability to make FFELP loans for AY 08-09?

___Yes ___No

5. If yes to #4, please describe, including loan availability and/or reduction in borrower benefits.

_____

_____

6. If you participate in non-federal student loans, have you received any information from lenders as to their ability to make such loans in AY 08-09?

___Yes ___No

7. If yes to #6, please describe, including loan availability, interest rate charged, and/or reduction in borrower benefits.

_____

_____

8. To the extent that non-federal student loans cease to be available to some or all students at your institution, what action do you anticipate taking to assist these students in meeting their financing needs? (Check all that apply)

___ A. Would offer loans using institutional funds
___ B. Would substitute grant or work for loans
___ C. Have no plan
___ D. Other (please specify)

_____

_____

National Association of Independent Colleges and Universities

9. On a scale from 1 to 5, where 1 is not at all important and 5 is critically important, how important is private student loan borrowing to your institutional financial health?

Please circle one number: 1.....2.....3.....4.....5

10. To the best of your ability, please estimate what percentage of your students take out private loans, and what the average private loan debt per student is upon their leaving the institution.

___% $_____

11. Do you have any general comments about the impact of the current credit crunch on your institution and/or your students? (Attach an additional sheet if necessary.)

_____

_____

In the event that we need to follow-up for additional data, please provide the following contact information:

Name(s):

Title(s):

Telephone(s):

Email(s):

_____

Please complete the survey, if possible, by Friday, March 7, but by March 14 at the latest.

Fax your completed survey to NAICU at 202-835-0003, or mail it to:

Debt and Loan Survey

NAICU

1025 Connecticut Ave., N.W., Suite 700

Washington, D.C. 20036-5405

For any questions about the survey, please contact Frank Balz, Vice President for Research and Policy Analysis at 202-785-8866. Thank you for your help.

Hearing of the US Senate Committee on Banking, Housing, and Urban Affairs
Turmoil in U.S. Credit Markets: Impact on the Cost and Availability of Student Loans

Testimony by Mark Kantrowitz, Publisher, FinAid.org

Thank you Chairman Dodd, Ranking Member Shelby and the distinguished members of the Senate Committee on Banking, Housing and Urban Affairs for convening this hearing and for the opportunity to appear before you.

I am Mark Kantrowitz, Publisher of FinAid.org and Director of Advanced Projects for FastWeb.com. FinAid is the most popular free web site for student financial aid information, advice and tools. FastWeb is the largest free scholarship matching service.

Contagion from the subprime mortgage credit crisis has infected the education loan marketplace. There have been no successful bond issues for state loan agencies and no securitizations of private student loans since last fall. While there have been some securitizations of federally-guaranteed student loans, the volume is down by 57% year-over-year and the cost of funds has increased by 137 basis points. None of these securitizations have involved federally-guaranteed student loans originated since October 1, 2007. The auction-rate securitization market is dead. These problems are occurring despite the AAA-rating of the student loan securities.

The lack of liquidity has lead to an unprecedented exodus of education lenders from federal and private student loans. As of today, 57 education lenders have suspended their

participation in federally-guaranteed student loans and 19 lenders have suspended their private student loan programs.

In FY2006 these lenders originated more than $6.5 billion in Stafford and PLUS loans to more than 800,000 borrowers and more than $48.5 billion in consolidation loans to more than 1.6 million borrowers. That represents 13% of Stafford and PLUS loan volume and 67% of consolidation loan volume.

These lenders include 21 of the top 100 originators of federal Stafford and PLUS loans and 27 of the top 100 originators of federal Consolidation loans. The top 100 lenders originate 91.5% of Stafford and PLUS loans and 99.8% of Consolidation loans.

Last week Sallie Mae, the largest education lender, announced that it will no longer be making consolidation loans. The Education Resources Institute (TERI), the largest nonprofit guarantor of private student loans, filed for Chapter 11 bankruptcy. Nelnet sold $1.2 billion of student loans for an after-tax loss of $28 million. There have been more than 2,500 layoffs industry-wide.

The credit crisis has also had a direct impact on borrower eligibility for federal and private student loans. Borrowers with a foreclosure in the last five years are ineligible for the federal PLUS loan. There will be about a 10% increase in PLUS loan denials at the start of the 2008-2009 student loan season. Lenders are also tightening credit underwriting criteria for private student loans. Credit score requirements are increasing

from 620 to at least 650 and approval rates have dropped by 10% to 25%. Overall, more than 100,000 additional families will become ineligible for both the federal PLUS and private student loans.

The cost of federal and private student loans has also increased. Most lenders have cut their Stafford and PLUS loan discounts in half and have eliminated discounts on consolidation loans. More than a dozen private student loans have increased the interest rates by an average of 7/8 of a percent.

These are signs of a very serious threat to our nation's education financing system and cause for concern. Without loans, some students may be forced to drop out of college.

Existing solutions are inadequate. Neither the Direct Loan program nor the lender-of-last-resort program has been tested under the extreme conditions we face today. For example, Federal Direct Consolidation Loan volume will be more than four times last year's volume and more than twice the peak volume. Neither program addresses the liquidity problems that are forcing education lenders to exit the marketplace. Both are reactive solutions that offer the potential for significant disruption during any transition period.

It is better to implement proactive solutions that prevent a crisis. The most effective solutions will involve injecting liquidity into the student loan system. Three possible approaches include allowing the Federal Home Loan Bank and the Federal Financing Bank to invest in highly-rated student loan securities, allowing lenders to pledge highly-

rated student loan securities as collateral for the Term Securities Lending Facility and conducting a reverse student loan auction in which lenders would compete for US Treasury investment in highly-rated student loan securities. The third approach would set margins competitively and is of limited duration, minimizing the need to wean lenders off of a source of cheap capital.

Other proposed solutions are aimed at restoring investor confidence. These include standby loan purchase agreements, government insurance of bonds and securitizations against lender default and eliminating the index rate mismatch. (Currently federal education lenders receive income that is indexed to the three-month Commercial Paper Rate while their cost of funds is indexed to the LIBOR index. Eliminating this index rate mismatch would yield more predictable spreads and would simplify the structure of student loan ABS by avoiding the need for interest rate swaps.) These solutions would reassure investors by reducing some of the risks associated with investing in these instruments.

Chairman Dodd and Ranking Member Shelby, I once again thank you and the committee for taking an interest in ensuring the continued availability of education loans, and for inviting me to share my thoughts on the matter. I would be happy to answer any questions you may have.

Highlights of the Student Loan Credit Crunch
Mark Kantrowitz, Publisher, FinAid.org

- Pullback in the capital markets
  - FFELP securitization volume down 57% year-over-year
  - No securitizations of FFELP loans originated since 10/1/07
  - No securitizations of private student loans since last year
  - No successful bond issues by state loan agencies since last year
  - Auction-rate securitization market is dead
  - Cost of funds has increased by 137 basis points
  - Index rate mismatch of 35 to 40 basis points, up from 7 basis points
  - College Cost Reduction and Access Act of 2007 cut 65 to 72 basis points from for-profit lender margins and 50 to 57 basis points from non-profit lender margins
- Unprecedented exodus of education lenders
  - 57 lenders have suspended participation in one or more federally-guaranteed education loan programs (50 from all of FFELP, 7 just consolidation loans)
  - 19 lenders have suspended private student loan programs
  - Every type of lender is affected, including 9 non-profit state loan agencies, 19 banks, 2 non-profit lenders, 2 credit unions and 26 non-bank lenders
  - More than 2,509 layoffs industry-wide
  - Major lenders have suspended their participation
    - 8 of the top 10 consolidators
    - 27 of the top 100 consolidators
    - 21 of the top 100 originators of Stafford and PLUS loans
  - Large percentage and amount of loan volume
    - 13.0% of FY2006 FFELP Stafford and PLUS loan volume
    - 67.1% of FY2006 FFELP Consolidation loan volume
    - $6.5 billion in Stafford and PLUS loans to more than 800,000 borrowers
    - $48.5 billion in Consolidation loans to more than 1.6 million borrowers
  - An additional 46 school-as-lender schools have lost their lender partners.
    - 3.3% of FY2006 FFELP Stafford and PLUS loan volume
    - $1.6 billion in Stafford loan volume to 200,000 borrowers
    - 10 of the top 100 originators of FFELP Stafford and PLUS loans
- Cost and availability
  - Lenders cutting Stafford and PLUS loan discounts in half
  - Lenders eliminating Consolidation loan discounts
  - Lenders increasing interest rates on private student loans by an average of 0.86%
  - Lenders raising FICO score thresholds on private student loans from 620 to 650 or even 680 or 700
- Recent events
  - Sallie Mae, the nation's largest education lender, stopped making consolidation loans and suspended its Stafford loan fee waiver program
  - The Education Resources Institute (TERI), the largest nonprofit guarantor of private student loans, filed for Chapter 11 bankruptcy
  - Nelnet sold two portfolios of loans totaling $1.2 billion for an after-tax loss of $28 million

Student Aid Policy Recommendations

Solving the Student Loan Credit Crunch

Mark Kantrowitz
Publisher, FinAid.org

March 10, 2008
Revised March 23, 2008[1]
Last updated April 11, 2008

INTRODUCTION

The subprime mortgage credit crisis, when combined with the lender subsidy cuts from the College Cost Reduction and Access Act of 2007, has presented significant challenges to the nation's education lenders. These challenges have caused several prominent education lenders to suspend their participation in federal and/or private student loan programs, often with little or no advance notice. Most of the remaining lenders have cut borrower benefits[2] on federal education loans and many have increased interest rates and fees on private student loans especially to borrowers with bad or marginal credit. The lenders are also eliminating subprime exposure by establishing more stringent credit underwriting criteria for their private student loan products and by curtailing the marketing and origination of federal student loans at high default rate schools. PLUS loan denial rates are also likely to increase due to an increase in foreclosures and repossessions. There is also the potential for significant short-term disruptions to the federal and private education loan programs when lenders run out of the liquidity needed to make new loans. These challenges will reduce the availability of federal and private education loans somewhat, especially to subprime borrowers, and will increase the cost to all borrowers.

The purpose of this policy paper is to summarize the current problems faced by the student loan industry, evaluate the impact on borrowers and to suggest solutions. The solutions are focused on increasing federal education loan limits, injecting liquidity into the federal education loan system and eliminating the index rate mismatch.

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[1] Data concerning lender cost of funds has been updated to include weighting by the weighted average life of the credit tranche in addition to the principal balance. The weighted average life is based on a 12% Constant Prepayment Rate (CPR) model. This increased the cost of funds by up to 13 basis points. The paper also includes additional detail and discussion and an improved presentation.

[2] Except for up-front fee waivers, these discounts usually have negligible impact on cost. See Mark Kantrowitz, *Evaluating Student Loan Discounts*, Student Aid Transcript 18(2):32-38, NASFAA, July 2007. The improvements to student aid enacted by the Higher Education Reconciliation Act of 2005 and the College Cost Reduction and Access Act of 2007 yield a greater financial benefit to students than the loss of loan discounts.

EXECUTIVE SUMMARY

The turmoil in the capital markets is leading to decreases in availability and increases in costs for both federal and private student loans. It is also generating a bit of turbulence as lenders have suspended their participation in federal and private student loan programs. The main actual and potential impacts involve borrower eligibility, lender availability and loan cost.

Borrower Eligibility

- An increase in PLUS loan denials for the 2008-09 student loan season because more borrowers will have an adverse credit history due to the increase in foreclosures. The additional unsubsidized Stafford loan eligibility for dependent undergraduate students whose parents were denied a Parent PLUS loan falls short of the average PLUS loan. Graduate and professional students do not have such a safety net when they are denied a Grad PLUS loan. Prospective borrowers with a foreclosure are also unlikely to qualify for private student loans or home equity lines of credit.

- More stringent credit underwriting criteria for private student loans will mean that subprime borrowers (FICO score under 650) and even some borrowers with FICO scores as high as 680 or 700 may find it more difficult to obtain a private student loan without a creditworthy cosigner. Lenders are looking at institutional default rates, graduation rates and job placement rates, especially at for-profit and community colleges, when deciding whether to provide private student loans to students at those schools.

- Approximately 1% to 2% of borrowers will be ineligible for the PLUS and private student loans as a result of the increase in foreclosures and tightening of credit underwriting criteria.

Lender Availability

- Some Federal Family Education Loan Program (FFELP) lenders are no longer making Stafford and PLUS loans at eligible colleges that have higher default rates. This may limit the availability of federal student loans at colleges that have cohort default rates of 10% or more. These colleges may have difficulty finding replacement lenders and may have to switch to the Direct Loan program.[3]

- Lenders representing 12% of Stafford and PLUS loan origination volume and 39% of Consolidation loan volume have suspended their participation in those loan programs.

[3] 59 colleges applied to join the Direct Loan program in January and February 2008. 45 of the applications were from for-profit colleges. The average number of schools joining the Direct Loan program from 2000-01 through 2005-06 was 44 per year.

- Many of the non-bank lenders and state loan agencies that continue to originate loans are working off of existing liquidity. Unless there is a thawing of the capital markets more lenders are likely to suspend federal and private loan program participation within the next year. However, several of the larger banks are using the withdrawal of non-bank lenders and state loan agencies as an opportunity to increase market share.

Loan Cost

- FFELP lenders do not have pricing power on federal education loans, as the maximum interest rates and fees are set by law. However, they can still increase costs to the extent that they were previously offering limited discounts ("borrower benefits") on those loans. Many have cut the value of discounts on Stafford and PLUS loans in half and eliminated discounts on consolidation loans.

- Lenders have increased the interest rates on private student loans by 0.25% to 3.0%, especially for loans that are pegged to the Prime Lending Rate. More of the increases in interest rates are falling on borrowers with bad or marginal credit. The average increase was 0.86% for borrowers with bad or marginal credit.

Possible Solutions

While the Direct Loan and lender-of-last-resort programs have been offered as a potential solution for lenders leaving FFELP, the ability of those programs to compensate for the changes in the student loan marketplace have never been sufficiently tested. There is the possibility of significant disruption for a few months during a transition to these programs.

The following solutions could be implemented at no cost (and possibly significant profit) to the federal government while simultaneously saving borrowers money.

- Increase annual and aggregate unsubsidized Stafford loan limits, either for all borrowers or just independent students and students subject to a PLUS loan denial. Since the unsubsidized Stafford loans (as opposed to the subsidized Stafford loan) have a negative subsidy rate, the government could earn up to an additional $500 million per year from increasing these loan limits, enough for a $125 increase in the maximum Pell Grant. This would also save borrowers money by shifting debt from higher cost private student loans to lower cost federal loans. It would also improve access since private student loans are unavailable to low and middle income families with bad credit.

- Establish an Undergrad PLUS loan similar to the Grad PLUS loan to allow undergraduate students to borrow from the PLUS loan program with or without parental involvement. This would save the federal government up to $1 billion a year (enough for a $250 increase in the maximum Pell Grant) due to the higher interest rates and fees on the PLUS loan program, but would still save most

students money as compared with an average interest rate of 10% to 11% on private student loans. This also addresses concerns parents have about their inability to defer payments on the Parent PLUS loan while the student (as opposed to the parent) is in school[4] and about the student not being obligated to repay the Parent PLUS loan. Unfortunately this proposal would still be insufficient for borrowers with an adverse credit history.

- Offer a reverse loan auction in which the US Treasury would invest a limited amount of money in student loan securitizations, where the lenders who bid the highest cost of funds after adjusting for quality of the student loan paper would win the new investments. This will provide the lenders with additional liquidity to make new loans and some profit to the federal government because of the government's lower cost of funds. This could also jump start the securitization markets for federal student loans by serving as a vote of confidence in FFELP.

- Switch the special allowance payments from the Commercial Paper Rate to the LIBOR index in a cost-neutral fashion. This would eliminate the index mismatch between lender revenues and their cost of funds, providing them with more predictable spreads.

These proposed solutions are focused more on liquidity and the availability of student loans and less on costs. Making sure that students have access to cash flow assistance is more important than the cost of that financing in ensuring access to a higher education.

THE PROBLEMS

Non-bank lenders rely on credit warehousing facilities[5] and the capital markets[6] as a source of funds. Initially a lender uses the credit warehousing facility as a source of funds to make new loans. As soon as the lender has originated enough loan volume (usually at least $100 million, but $1 billion is more common these days) the lender transfers the loans to a trust and sell shares in the trust to investors at a premium through a process called securitization. The proceeds from the securitization are used to repay the credit warehousing facility. This not only provides the lender with a lower cost of capital than the credit warehousing facility, but also provides the lender with about half of its future profits up front. The rest of the lender's profits are earned over time from servicing and advisory fees. A key to lender profitability involves minimizing the use of the higher cost credit warehousing facility by originating as much loan volume as possible in as short a time as possible so that one can securitize as frequently as possible.

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[4] If Congress does not establish an Undergrad PLUS loan it should consider amending Section 428B(d)(1) by inserting "or dependent undergraduate student on whose behalf the parent is borrowing" after "parent" to permit an in-school deferment when the student is in school.

[5] A credit warehousing facility is a large loan of $500 million to several billion dollars typically made by a large international bank.

[6] The capital markets used by education lenders include asset-backed securitizations and bond issues.

The subprime[7] mortgage credit crisis has lead to a significant decrease in investor interest in all securitizations, not just those involving subprime mortgages. This is clearly an irrational overreaction, since the quality of the student loan assets are still among the best available. For example, federal education loans are guaranteed against default by the federal government,[8] so investors should not care much about subprime exposure.[9] Private student loans, although not federally-guaranteed, usually have less than about 11% exposure to subprime borrowers[10] and then only to the best quality subprime borrowers (e.g., FICO scores of 620 to 650) and not the full spectrum. The risk associated with these assets is about half of the 20% risk weighting assumed for all Triple-A rated obligations. But the practical reality is all that really matters.

The decrease in investor interest has lead to a significant disruption of the capital markets. There have been no public securitizations of private student loans since First Marblehead's 2007-4 securitization of $1.4 billion on September 17, 2007. Roughly two-thirds of that securitization was auction rate, with only $550 million at the 1-month LIBOR plus a margin of 0.85%.[11] That was up from the weighted average rate of 1-month LIBOR plus 0.37% in the 2007-2 securitization.[12] The securitization of federal loans has been occurring at a slower pace and smaller size than previously, despite an increase in loan volume waiting for securitization. There have also been fewer classes in the securitizations. Also, none of the securitizations since October 1, 2007 have included any loans originated on or after that date.[13] There have also been no new state bond issues.

For example, consider the following chart of Sallie Mae's federal education loan securitizations. The average securitization through October 12, 2006 was roughly $2.5 billion. This increased to $3.7 billion through July 19, 2007 but plunged to $1.7 billion from October 2007 to the present. Total securitization volume in the first quarter is down 57% year over year. Investor demand is so low that Sallie Mae was forced to decrease the size of its latest offering and increase the margin to 80 basis points.

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[7] Subprime is generally defined as having a FICO score less than 650.

[8] Currently a 99% guarantee for exceptional performers and 97% for other lenders, both decreasing to a 95% guarantee starting on October 1, 2012.

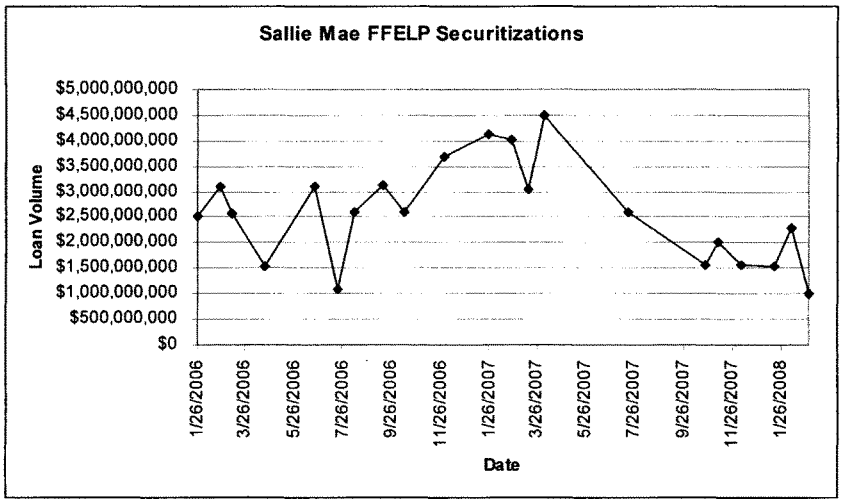
[9] Besides the small amount of risk sharing, there is also a prepayment risk when a borrower defaults. While the government may repay most of the principal and accrued but unpaid interest, the investor will not obtain the interest he or she was expecting to receive over the lifetime of the loan. To the extent that the default rates exceeded expectations, the investor may have overpaid for the loan. However, the impact of this default risk on a federally-guaranteed loan is minimal, only a few basis points.

[10] 8.0%, 6.1%, 9.5%, 10.5%, 10.3%, 10.1%, 10.8% and 10.9% for First Marblehead's 2006-1, 2006-2, 2006-3, 2006-4, 2007-1, 2007-2, 2007-3 and 2007-4 securitizations, respectively (9.5% average), and 8.8%, 17.6%, 12.2% and 8.2% for Sallie Mae's 2006-A, 2006-B, 2006-C and 2007-A private student loan securitizations, respectively (11.7% average). The "Other" category was included in the Sallie Mae totals but not the First Marblehead totals.

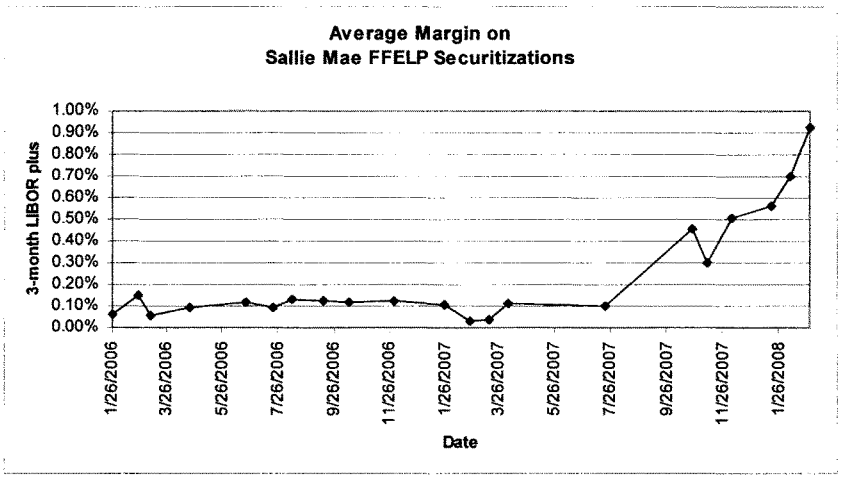
[11] This securitization was forced to omit the Triple-B tranche, the lowest investment grade typically included in securitizations.

[12] Using a 10% CPR weighted average life in addition to the principal balance in the weighted average.

[13] The combination of the increased cost of capital from the credit crisis and the decreased special allowance payments from the College Cost Reduction and Access Act of 2007 has lead to such narrow margins that post-10/1/07 loans cannot be securitized in the current environment.



The decrease in investor interest has forced lenders to pay more to get them to invest in the securitizations. Through July 19, 2007, the weighted average margin[14] paid relative to the LIBOR index was 10 basis points. It then jumped to 55 basis points and a recent peak of 93 basis points, an 83 basis point increase. The following chart shows how the weighted average margins (excluding a small amount of auction rate credit classes) on Sallie Mae's federal loan securitizations have changed since January 2006.

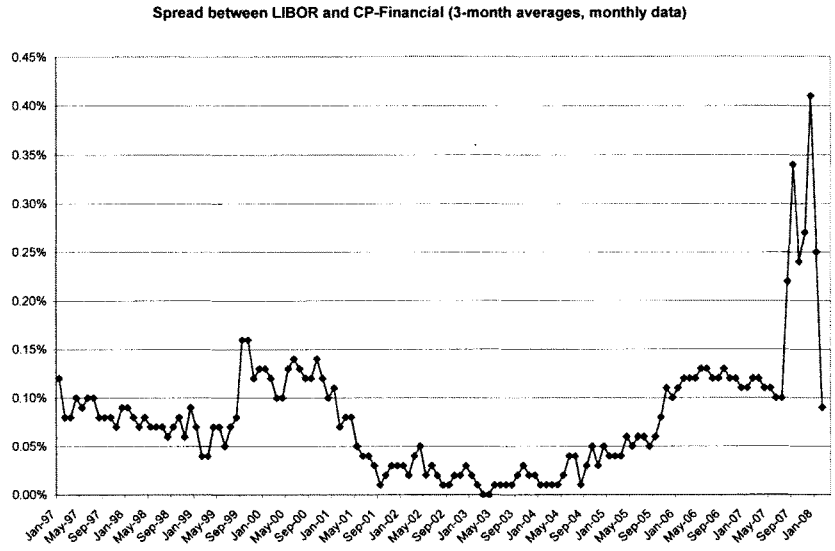


[14] Weighting based on loan principal volume and weighted average life assuming a 12% CPR Model.

When education lenders are not able to securitize their loan portfolios, they are forced to keep them on the credit warehousing facilities, which are more expensive. So either way the lender's cost of funds has increased significantly.

Index mismatches have been another important cause of margin compression for education lenders. An index mismatch occurs when the lender's income is pegged to a different index (base rate) than the lender's cost of funds. Both credit warehousing facilities and securitizations are usually pegged to the LIBOR index (either the 1-month or 3-month average). The special allowance payment on federal education loans, however, is pegged to the 3-month Commercial Paper Rate. While about half of all private student loans are pegged to the LIBOR index, and so have no index mismatch, two-fifths are pegged to the Prime Lending Rate.

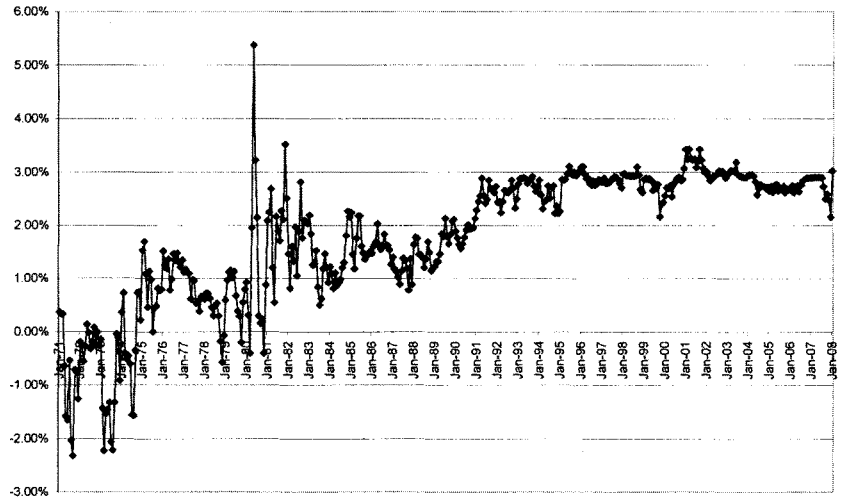
When there is an index mismatch, changes in the spread between the two indexes can affect the lender's profitability. The following chart shows how the spread between the Commercial Paper Rate and LIBOR index increased from 3 basis points in 2001-2005 to 12 basis points in 2006 and the first half of 2007 and then jumped to an average of 26 basis points and a peak of 41 basis points.[15] (The peak spread was 48 basis points in weekly data for December 7, 2007.)



The following chart shows that the spread between the Prime Lending Rate and the 3-month LIBOR index has been growing over time.

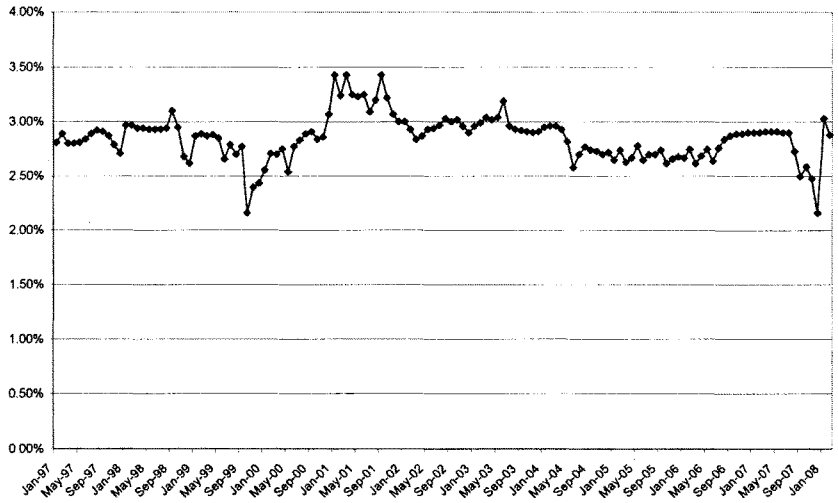
[15] The spread dropped to 16 basis points in March 2008 but was 35 basis points the week of April 4, 2008.

Spread PRIME over 3 Month LIBOR



However, the spread has been relatively stable over the past decade, as can be seen in the following enhanced detail on the data since January 1997.

Spread PRIME over 3 Month LIBOR (January 1997 to February 2008)



The credit crisis has caused the spread between the 3-month LIBOR index and the Prime Lending Rate to drop from the usual 2.91% to as low as 2.16%, a difference of 75 basis points.[16]

Several lenders have reacted by increasing the interest rates on their private student loans by 25 to 300 basis points, with an average increase of 0.86% in the rates charged to borrowers with bad or marginal credit and an average increase of 0.79% in the rates charged to borrowers with excellent credit. More of the increases have occurred on private student loans that are pegged to the Prime Lending Rate, and mostly on the interest rates offered to the prospective borrowers with the worst credit scores.[17] Banks are less likely to increase interest rates than non-bank lenders.

Finally, the College Cost Reduction and Access Act of 2007 cut for-profit lender subsidies[18] by 65 to 72 basis points and not-for-profit lender subsidies by 50 to 57 basis points.[19] (These cuts were used to pay for increases in the maximum Pell Grant, cuts to the interest rates on subsidized Stafford loans for undergraduate students, increases in the amount of money students can earn before it affects aid eligibility, the addition of a new grant program for students interested in teaching in national need areas, and the introduction of the income-based repayment plan and public service loan forgiveness.) In particular, the special allowance payments on Stafford loans were cut by 55 basis points and on PLUS loans by 85 basis points, yielding a special allowance payment of the 3-month Commercial Paper Rate plus 1.79% for both. The special allowance payments on consolidation loans were also cut by 55 basis points, yielding a net payment of the 3-month Commercial Paper Rate plus 1.04%. Consolidation loans have a 75 basis point tighter spread than Stafford and PLUS loans.

In effect, the education lenders have experienced margin compression at the top (cuts to the lender subsidies), bottom (increases in cost of funds) and middle (index mismatch). This makes it much more difficult for them to earn a profit. The following is a worst-case spread analysis for Stafford and PLUS loans originated after October 1, 2007 by a for-profit lender:

Gross Income:	3-month CP + 1.79%
Risk Sharing:	-0.05%
Lender-Paid Origination Fees:	-0.10%
CP-LIBOR Mismatch:	LIBOR – 3-month CP - 0.40%
Net Income:	LIBOR + 1.24%
Cost of Funds:	LIBOR + 0.93%
Spread:	0.51%

[16] The spread seems to have recovered recently, returning to 2.88% in February 2008.
[17] Less than 10% of borrowers get the best advertised rate on private student loans and more than 2/3 get the worst rates, so a lender can improve its average spread by increasing the worst interest rates while seeming to still offer a good deal by leaving the best rates unchanged.
[18] These consist primarily of cuts in the special allowance payments, increases in risk-sharing (decreases in the insurance percentage) and increases in lender-paid origination fees.
[19] See www.finaid.org/educators/2007subsidycuts.txt

From this 51 basis point spread the lenders must pay approximately 70 basis points of origination and servicing costs,[20] as well as "borrower benefits".[21] Not counting servicing costs, which are offset by servicing fees paid by the student loan trust, the net spread after deducting the other costs is approximately 16 basis points. While this is a worst-case and hopefully temporary scenario, it seems clear that Stafford and PLUS loans are now only marginally profitable for the for-profit lenders due to the combined impact of the credit crisis and the cuts in the lender subsidies.[22] Moreover, since margins on consolidation loans are 75 basis points tighter, it seems clear that consolidation loans are no longer profitable. This has forced lenders to cut costs and discounts. For example, there have been more than 2,500 layoffs industry-wide and many lenders have cut the value of Stafford and PLUS loan discounts in half and eliminated consolidation loan discounts entirely. Some lenders have eliminated all discounts. Others are switching to more profitable private student loan programs. It is also potentially significant that there have been no securitizations of loans originated since October 1, 2007 as the margins in the current environment are too thin.[23]

The spread analysis example given above was for a for-profit lender. Not-for-profit lenders have an additional 15 basis points of spread. Yet even they are still experiencing problems, as discussed below. This underscores that the current crisis is first and foremost a liquidity crisis. Cost of capital and liquidity are intertwined. When a lender is unable to securitize its loan portfolio, it has to rely on higher cost credit warehousing facilities.[24] But the bottom line is that without liquidity a lender cannot make new loans regardless of the margins.

In addition to the previously described problems plaguing the student loan industry, there has also been an unprecedented complete collapse of the auction-rate securitization markets. With auction-rate securitization the interest rate is reset periodically (typically

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[20] The securitization prospectuses for Sallie Mae provide for a servicing fee of up to 50 basis points in the 2006-1 through 2007-8 securitizations and a servicing fee of up to 90 basis points in the 2008-1 through 2008-3 securitizations. The servicing fee switched in 2008 from a percentage of the outstanding principal to a unit basis of $1.50 per month per borrower in the in-school period, $2.75 per month per borrower in the grace period and $3.25 per month per borrower in all other statuses (repayment, deferment, forbearance, etc.), with a monthly cap of 1/12th of 0.90% of the outstanding principal balance. Since servicing costs are approximately 35 basis points, it would appear that Sallie Mae's revenues have shifted somewhat from the spread to the servicing fees.

[21] The 70 basis point figure was provided to the Congressional Research Service by Sallie Mae.

[22] The cost of funds has been getting progressively worse. Sallie Mae's 2008-3 securitization at an average weighted margin of 93 basis points over LIBOR was in February 2008. Citibank's 2008-1securitization and Nelnet's 2008-2 securitization, both in March 2008, were at weighted average margins of 144 and 143 basis points over LIBOR, respectively.

[23] The rating agencies require lenders to have some extra margin beyond the amounts paid to investors. This "credit enhancement" ensures that the lender will be able to continue making the interest payments on the securitizations and bonds even if market conditions change. Other credit enhancements besides excess interest include a third party guarantee against default by the underlying student loans and a reserve account. The securitizations may also be wrapped with a note guarantee insurance policy to ensure the timely payment of interest (i.e., guarantee against default by the issuing lender).

[24] There is a bit of a chicken-and-egg or maybe Gordian knot. Higher cost of capital yields thin margins that prevent securitizations which could have yielded a lower cost of capital. Unless there is a dramatic change the present situation is likely to be self-sustaining.

every 35 days) through investors buying and selling the existing securitizations. This makes a long-term obligation, such as a student loan or mortgage, act more like a short-term debt. This is attractive to businesses that are looking for a place to park their excess cash on a short-term basis. Unfortunately, a crisis of confidence in this particular type of instrument has caused almost all such auction-rate securitizations to fail recently. It is, in effect, a self-fulfilling prophecy: investors aren't investing in them because investors aren't investing in them, so there's no liquidity. Investors are universally trying to reduce their exposure to this form of investment. Moreover, when investors are unable to sell these securities, the interest rates switch to a default rate specified in the securitization prospectus, significantly increasing the cost to the lender (e.g., one lender saw its rates increase from 5% to 18%, resulting in hundreds of thousands of dollars of unanticipated costs). This has caused many lenders to try to refinance the debt to reduce costs, putting more pressure on already stressed capital markets. There is, after all, no guarantee that the problem won't persist at the next rate reset. In fact, it seems clear that the auction-rate securitization market is dead unless the government does something to jump-start it (highly unlikely).

The increased costs have lead to several of the nonprofit state loan agencies suspending loan programs or other benefits in order to conserve cash. There have been almost no new state student loan bond issues, so the states are spending down existing liquidity to make new loans. Several of the states have suspended their private student loan programs (e.g., Michigan's MI-LOAN and New Hampshire's LEAF) or loan discounts (e.g., Northstar Guarantee's T.H.E. Bonus) or consolidation loan program (e.g., Missouri, Indiana and Colorado) in order to conserve capital for the Stafford and PLUS loan programs. Three state loan agencies (Pennsylvania, Texas and Minnesota) have suspended their student loan programs entirely.

Relying on credit warehousing facilities is not a long-term solution, as these facilities are intended to provide short-term liquidity and the lenders providing the facilities will generally not increase the amount of available credit by much. Credit warehousing facilities need to be refinanced periodically. For example, Sallie Mae's recently closed $35 billion in credit warehousing facilities is a 364-day refinancing of their previous $30 billion in interim credit warehousing facilities from JPMorgan Chase and Bank of America. As such it does not provide much new lending liquidity.[25] The cost of the credit warehousing facilities is also high enough to preclude profitability if the non-bank lenders rely on them for too long.[26] The credit warehousing facilities are mainly a method of weathering the storm until the lenders are again able to tap into the asset-backed securitization market for a lower cost of capital.

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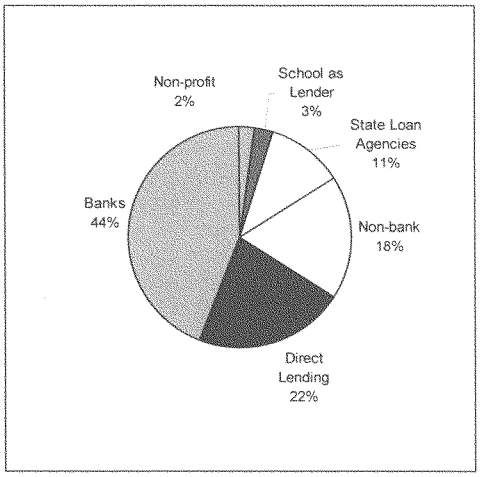
[25] Sallie Mae 8-K SEC filing dated 2/29/08. $23.4 billion of FFELP ABCP, $5.9 billion of private ABCP, $2.0 billion of secured FFELP, plus an additional $3.5 billion for ABCP and the potential of an additional $2.6 billion in FFELP ABCP and $100 million in private ABCP.

[26] The cost of funds under the new Sallie Mae facilities for FFELP loans is LIBOR + 0.68% and for private loans is LIBOR + 1.55%. When all fees are factored in the overall cost of funds will likely be about LIBOR + 2.00%.

If the situation continues without remedy for more than a year it could lead to a mass exit of all non-bank lenders and nonprofit state loan agencies from the federal education loan programs, without much forewarning. The private student loan programs offered by these lenders are also at risk. When these lenders run out of liquidity, they cannot make new loans.

Already, 57 lenders have suspended some or all of their federal education loan programs. These lenders previously originated 13% of FFELP Stafford and PLUS loan volume[27] and 67% of consolidation loan volume.[28] Eight of the top ten largest loan consolidators have suspended their participation in the consolidation loan program. In addition, nineteen lenders have suspended their private student loan programs.



Non-bank lenders originate 17.9% of all federal education loans (excluding consolidation loans), state loan agencies originate 11.3% and other nonprofit lenders 2.3%.[29] Sallie Mae controls about two-thirds of non-bank loan origination volume and about ten percent of overall federal loan volume. If the non-bank lenders and state loan agencies are unable to originate new loans, there are other lenders available to replace them. Banks, in particular, are not as affected by the turmoil in the asset-backed securitization markets because they depend on customer deposits as a source of funds, not securitizations or credit warehousing facilities.[30] Banks originate 44.1% of all federal education loans. The Direct Loan program is another potential source of funds, as it originates 21.8% of all federal

[27] These figures include lenders that are not in the Top 100 list for FY2006 and loan marketers that were not directly Title IV participants. The figures include more than $6.5 billion of Stafford and PLUS originations to more than 800,000 borrowers and more than $48.5 billion of consolidation loan volume to more than 1.6 million borrowers. So far 27 of the top 100 consolidators and 21 of the top 100 Stafford and PLUS originators have suspended participation in the loan programs.

[28] Borrowers who are unable to find a FFELP lender willing to consolidate their federal education loans can consolidate them with the Direct Loan program, loanconsolidation.ed.gov, even if their alma mater did not participate in the Direct Loan program.

[29] These figures are derived from a spreadsheet from the US Department of Education listing the Top 100 originating lenders for FY2006. These lenders originate 90.8% of all FFELP loans.

[30] Banks such as JPMorgan Chase and Bank of America are often the source of the credit warehousing facilities relied upon by the non-bank lenders. However, smaller banks rely on secondary markets as a source of liquidity instead of holding the loans until maturity. When the secondary markets have limited or eliminated their loan purchases and decreased the premiums they pay to acquire loans, this has had a cascading impact on such lenders. For example, HSBC, TCF Bank and M&T Bank have all suspended their FFELP loan originations.

education loans. School-as-Lender schools originate 2.6%.[31] Lenders that are most likely to be affected by the turmoil in the ABS and bond markets represent about a third (31.5%) of the federal student loan marketplace. These lenders tend to dominate the private student loan marketplace, which represents 20% of overall education loan volume. So at most half of all new education loan origination volume is potentially at risk of disruption.

The banks see the withdrawal of non-bank lenders and state loan agencies as an opportunity to gain market share. However, there is a limit to their capacity and willingness to absorb loan volume on both a short-term and long-term basis.[32] (Some banks do not hold the loans until maturity and instead sell the loans to a secondary market shortly after origination. The shutdown of the secondary market has forced several medium and large-sized banks to leave the federal student loan program.) The Direct Loan program can also increase its loan volume to compensate when education lenders exit FFELP. Borrowers who are unable to consolidate their loans with a FFELP lender can obtain a Federal Direct Consolidation Loan from the Direct Loan program.[33] With more than two-thirds of consolidators no longer making consolidation loans, the Federal Direct Consolidation Loan program is likely to see a four-fold increase in loan volume as compared with last year, more than double the peak loan volume. To obtain a Stafford or PLUS loan from the Direct Loan program, however, the borrower's college must participate in the Direct Loan program. It is unclear whether the Direct Loan program can handle a five-fold increase in the number of Direct Loan schools and a six-fold increase in the number of borrowers, as the capacity limits have never been tested.[34] This has the potential to lead to a bit of turbulence should the Direct Loan program need to ramp up capacity.[35]

The lender-of-last resort program is another existing option for addressing liquidity issues. Sections 428(j) and 428(c)(1)(E) of the Higher Education Act allows guarantee agencies (or the lenders they designate) to make loans with a 100% guarantee with funds provided by the US Department of Education. The Department can also substitute different special allowance payments. While the Higher Education Act limits the lender-

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[31] School-as-Lender is in the process of being phased out and is not a practical source of liquidity, as the lenders are restricted to originating Stafford loans to graduate students only, and only at their schools. Most school-as-lender schools flip the loans shortly after full disbursement. The lender partners for 46 school-as-lender schools have suspended their purchases of these loans, forcing the schools to seek new partners.

[32] The banks are likely to focus on the most profitable highest credit quality paper and not pursue loans from subprime borrowers or with thin margins. Like the non-bank lenders and state loan agencies, they are also likely to minimize lending at colleges with low graduation rates and high default rates. They already have significant exposure to student loan paper through the credit warehousing facilities they provide to non-bank lenders. They will not make new loans indiscriminately.

[33] See loanconsolidation.ed.gov

[34] The increase is unlikely to be that extreme, unless the leading Democratic presidential candidates are successful in eliminating the FFELP program, as even in a worst-case scenario there are likely to be 15 or more large lenders still participating. But it is not unreasonable to expect that total Direct Loan volume will increase by a factor of 2 to 3.

[35] There were problems in the early days of the Direct Loan program. However, the Direct Loan program handled the doubling of consolidation loan volume in 2005, when borrowers could lock in rates as low as 2.88%, without significant problems. Yet the potential increase in direct loan volume is much greater now.

of-last-resort program to borrowers eligible for the subsidized Stafford loan, the regulations at 34 CFR 682.401(c)(2) expand this authority to include borrowers of unsubsidized Stafford and PLUS loans, without regard to whether the borrower qualifies for a subsidized Stafford loan. The lender-of-last-resort program, however, has never been tested and so there may be a bit of turbulence should the Department need to launch the program, especially if it has to implement it on short notice.[36]

But there are actually more serious problems that represent a clear and present danger to students and institutions of higher education. These involve increases in PLUS loan denial rates, lenders refusing to lend at some eligible institutions, and more stringent credit underwriting standards for private student loan programs.

The PLUS loan program involves a modest credit check that looks for the existence of an adverse credit history. One of the components of an adverse credit history is a foreclosure in the last five years. To the extent that the subprime mortgage credit crisis was precipitated by an increase in foreclosure rates, it is reasonable to expect an increase in PLUS loan denial rates for the 2008-09 education loan season.[37] [38] The regulations at 34 CFR 682.201(c)(2)(iii) allow lenders to establish "more restrictive credit standards" for the PLUS loan program. While it is unclear whether lenders have already implemented stricter credit underwriting for the PLUS loan program, such as FICO score thresholds, it is apparent that many lenders are no longer exercising their authority under 34 CFR 682.201(c)(2)(ii) to approve a PLUS loan despite an adverse credit history when extenuating circumstances exist.

When the parent of a dependent undergraduate student is denied a Parent PLUS loan, the student becomes eligible for increased unsubsidized Stafford loan limits. The additional loan eligibility includes an additional $4,000 per year during the freshman and sophomore years and an additional $5,000 per year during the junior and senior years. This falls short of the average $11,000 PLUS loan.[39] Graduate and professional students who borrow from the Grad PLUS loan do not have this safety net if they are denied a PLUS loan. Since PLUS loan borrowers represent approximately 10% of federal loan borrowers and most will still be approved, only a few percent of borrowers – 80,000 to 100,000 students – are likely to be affected by an increase in PLUS loan denials. Prospective borrowers with a foreclosure, however, are unlikely to be able to obtain a

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[36] While both the Direct Loan program and lender-of-last-resort provide viable albeit untested emergency solutions, both are reactive solutions that would require waiting until a failure had already occurred. A better approach is to proactively inject liquidity into the FFELP loan programs.

[37] Since borrowers typically obtain their PLUS loan approvals at or before the start of the academic year, and those approvals are good through the end of the academic year, one would not expect to see an increase in PLUS loan denials until the start of the 2008-09 academic year.

[38] PLUS loans are obtained by approximately 10% of federal education loan borrowers, not including consolidation loans, and represent 17% of federal education loan volume, not including consolidation loans. Assuming a 50% increase in PLUS loan denials (not unreasonable based on RealtyTrac foreclosure and repossession rate data) and a current 20% PLUS loan denial rate would yield a 30% PLUS loan denial rate. Combined this suggests that approximately 1% of federal education loan borrowers will be affected.

[39] According to the President's FY2009 budget baseline spreadsheets the average PLUS loan in 2008-09 will be $11,118 (DL and FFEL) and $11,309 (FFEL only). Aggregate PLUS loan borrowing is about double annual PLUS loan borrowing, as is discussed below.

private student loan or a home equity line of credit and so may be forced to rely on credit cards or drop out of college.

Some lenders have decided to stop making federal and private education loans at certain types of institutions, such as for-profit and community colleges. Others have adopted limits on cohort default rates that are tighter than those established by Congress. For example, while the Higher Education Act specifies that colleges become ineligible for federal education loans when their cohort default rate exceeds 40% in a single year or 25% for three years in a row, at least one lender has adopted a lower 10% threshold. While other lenders will likely take over for the withdrawal of this lender, there is the potential that students at an eligible institution will be denied access to federal student loans.

Such actions are not precluded under the current anti-discrimination rules as encoded in the Higher Education Act in sections 421(a)(2), 428C(b), 438(c), 439(e) and 440A and the regulations at 34 CFR 682.404(h) and 34 CFR 682.800.[40] Specifically, prohibitions on discriminating based on the borrower's income, attendance at a particular eligible institution or length of the borrower's educational program only apply to Sallie Mae, the guarantee agencies, and 9.5% floor income lenders. In addition there is a ban on discrimination for consolidation loans based on the "type or category of institution of higher education that the borrower attended". There is no language in the statute or regulations that precludes other lenders from discriminating against students at eligible schools based on income, default rates, graduation rates or credit scores, for example. Likewise there is nothing to preclude any lender, including Sallie Mae, from discriminating in its marketing practices (e.g., by asking a school to not include the lender in its preferred lender list).

Lenders have also been tightening their credit underwriting criteria for private student loans. Because they are unlikely to be able to securitize loans made to subprime borrowers in the future, many lenders have been eliminating all of their subprime exposure. For example, on January 18, 2008, Sallie Mae sent a letter to several for-profit colleges, including Corinthian, Career Education, ITT Educational Services, DeVry, Education Management Corporation and Lincoln Educational Services, informing them that it would be ending its recourse loan programs effective March 1, 2008. While some of these colleges announced that other lenders would be replacing Sallie Mae, loan approval rates have apparently decreased significantly. It also appears that other lenders have increased their credit score thresholds to 650 or even 680 or 700 while not publicly announcing this change to their credit underwriting criteria. At least 10% of private student loan borrowers will be affected by the more stringent credit underwriting criteria.[41] Not all of them will be able to find creditworthy cosigners, so it is likely that a percent or two of borrowers – hundreds of thousands of students – will not be able to obtain a private student loan.

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[40] See www.finaid.org/loans/discrimination.phtml

[41] This 10% to 11% figure assumes that lenders raise the FICO score thresholds from 620 to 650. If they raise the threshold to 680, then 24% to 29% of private student loan borrowers will be affected. If they increase the threshold to 700, then 41% to 46% of private student loan borrowers will be affected.

The reduced availability of private student loans is not going to be limited to for-profit colleges. According to the 2003-04 National Postsecondary Student Aid Study (NPSAS), for-profit colleges account for 20% of undergraduate[42] private student loan borrowers, while 2-year colleges account for 15%, 4-year public for 32% and 4-year private non-profit for 32%. The NPSAS data does not include credit scores, so it is not possible to assess how many subprime borrowers attend each type of institution. However, a reasonable proxy is to limit the data to low income families, since credit scores tend to correlate with income. When the NPSAS data is limited to families with adjusted gross income (AGI) less than $50,000, for-profit colleges account for 29% of private student loan volume, 2-year colleges for 18%, 4-year public colleges for 26% and 4-year private non-profit colleges for 27%. So the impact of tighter credit underwriting standards will likely be well distributed among all types of colleges, albeit a little more concentrated at for-profit colleges and other colleges that serve low and moderate income students.

Unfortunately, cutbacks in private student loan eligibility represent an access problem. The fast growth of private student loan volume, now 20% of overall education loan volume, has been driven by several limitations and flaws in the federal education loan programs:

- Aggregate Stafford loan limits have remained unchanged since 1992. Congress is unwilling to increase these limits because of the high cost of the subsidized Stafford loan program. Some public policy advocates have argued that increasing federal student aid leads to increased college costs. However, college costs have increased despite the stagnant loan limits and despite four years of no increases in the maximum Pell Grant. When the federal government abdicates its vitally important role in ensuring access to higher education, it makes it more difficult for students to pay for college.

- More students are reaching the maximum annual and aggregate Stafford loan limits[43] and are unwilling[44] or unable to use the PLUS loan program.[45]

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[42] Considering the data for graduate students is not likely to be meaningful because the Grad PLUS loan was introduced on July 1, 2006, shifting most private student loan volume by graduate and professional students to the federal education loan programs.

[43] The cost of attendance at many colleges exceeds the sum of the maximum Pell Grant and the maximum Stafford loan available to dependent and independent students. Based on the 2003-2004 NPSAS, 62.2% of 4-year undergraduate Stafford borrowers are borrowing the maximum amount of Stafford loan eligibility available to them (68.9% among borrowers who did not receive the Pell Grant). This is a 6.1% increase compared with the 56.1% figure from the 1999-2000 NPSAS. These percentages include the additional unsubsidized Stafford loan limits available to independent students and to dependent students whose parents were denied a PLUS loan. The figures vary by year in school, with 73.0% of freshmen, 69.3% of sophomores, 58.0% of juniors and 52.1% of seniors borrowing to the limit. (The corresponding 1999-2000 figures are 71.3%, 63.9%, 51.3% and 43.4%.) It is reasonable to assume that more than two-thirds of 4-year undergraduate Stafford borrowers are currently borrowing to the limit, and more than three-quarters of 4-year undergraduate Stafford borrowers who do not qualify for the Pell Grant.

[44] Additional reasons why some families prefer private loans over the PLUS loan can be seen at www.finaid.org/loans/loantradeoffs.phtml.

- Approximately 20% of PLUS loan applicants have an adverse credit history and so are ineligible. This denial rate will increase in 2008-09.
- Independent students are not eligible for the PLUS loan program.
- The Parent PLUS loan program does not provide an in-school deferment when the student is in school, only when the parent is enrolled in college. Although some lenders have used administrative forbearances to provide the equivalent of an in-school deferment, this option is not available to most borrowers.
- The Parent PLUS loan is a parent obligation, not a student obligation. Even if they must cosign a private student loan, at least the student is also obligated to repay the debt.

- Students who are not making Satisfactory Academic Program (e.g., a 2.0 or better GPA) are ineligible for federal student aid and must rely on private student loans while they try to improve their grades.

The shift from federal to private loans makes it more difficult for low and middle income families to pay for college because private student loans are focused on profitability, not access. Low and middle income families are more likely to have bad credit or no credit. While some people may not think of financing as a form of student aid because it has to be repaid (and is not as effective as the Pell Grant program), it nevertheless provides critical cash-flow assistance. Few parents can afford to write a check for the full amount of their out-of-pocket college costs.

THE SOLUTIONS

There are several possible solutions to the student loan credit crunch which may be employed individually or in combination:

- Increase annual and aggregate unsubsidized Stafford loan limits.
- Establish an Undergrad PLUS loan similar to the Grad PLUS loan which would allow undergraduate students to borrow from the PLUS loan program with or without parental involvement.
- Offer a reverse loan auction in which the US Treasury would invest in student loan securitizations, providing education lenders with sufficient liquidity to make new loans.
- Switch the special allowance payments from the Commercial Paper Rate to the LIBOR index (in a cost-neutral fashion) to eliminate the index mismatch.

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[45] Based on the 2003-04 NPSAS, 91.1% of undergraduate students do not borrow from the PLUS loan program and 22.7% do not borrow from the Stafford loan program. Of undergraduate private loan borrowers who do not borrow from the Stafford loan program, 5.6% are international students, 10% have a GPA less than 2.0, 10.5% are using credit cards to pay tuition, 37.8% are independent, 16% are getting no help from their parents and 12.0% have parents who are divorced or separated. Of undergraduate private loan borrowers who do not borrow from the PLUS loan program, 1.4% are international students, 8.1% have a GPA less than 2.0, 8.2% are using credit cards to pay tuition, 36.7% are independent, 16.6% are getting no help from their parents and 13.1% have parents who are divorced or separated. These categories may overlap and do not total to 100%.

- Improve the US Department of Education's monitoring of the viability of FFELP.

These are all proactive solutions that are intended to avert a potential student loan credit crisis. In contrast, the existing tools – increasing Direct Loan origination volume and initiating the Lender-of-Last-Resort program – are both reactive solutions which will be implemented only after a crisis has already occurred and is apparent and so may involve a delay. As a result, reactive solutions will necessarily entail tolerating some disruption.

Increase Unsubsidized Stafford Loan Limits

As noted previously, Congress has been reluctant to increase Stafford loan limits because of the high cost of the subsidized Stafford loan program. Increasing the annual and aggregate loan limits for just the unsubsidized Stafford loan program could be accomplished under PAYGO rules at no cost to the government.[46] In fact, it would yield additional revenue to the federal government, as much as an additional $500 million a year. That would be enough for a $125 increase in the maximum Pell Grant, reducing student debt slightly. It would also save students money by shifting their borrowing from high cost private student loans to the lower cost federal student loans. (Federal student loans also have more flexible repayment options than private student loans and better protections for borrowers who encounter unfortunate events such as death, disability or school closures.) This proposal would also increase access to higher education since the government loans have less stringent eligibility requirements than private student loans, since private student loans are focused more on profit than the public good.

The following table is based on the subsidy costs for the federal education loans as published on page 364 of the Department of Education Appendix to the President's FY2009 budget:

Subsidy Rate	FFELP	Direct Loans	Weighted Average
Subsidized Stafford	16.67%	10.80%	15.46%
Unsubsidized Stafford	-3.07%	-9.97%	-4.34%
PLUS	-5.94%	-11.75%	-7.24%

A positive subsidy rate costs the government money. For example, the 16.67% subsidy rate for the subsidized Stafford loan in the FFEL program means that for every dollar the lent by a FFELP lender as a subsidized Stafford loan, it costs the government almost 17 cents. On the other hand, the table demonstrates that there is a negative subsidy rate in both the FFEL and Direct Loan programs for unsubsidized Stafford loans and PLUS loans. This means that increasing loan limits in these programs would probably save the government money. The increased loan limits would not yield increased default rates,[47]

[46] This could be accomplished by increasing the additional unsubsidized Stafford loan limits for independent students and undergraduate students whose parents were denied a PLUS loan. Alternately, Congress could increase the unsubsidized Stafford loan limits for all students.

[47] According to the President's FY2007 budget, FY2005 PLUS loan default rates were 5.41% in FFEL and 5.50% in DL. According to the President's FY2008 budget, FY2006 PLUS loan default rates were 5.20%

as it would mainly be shifting borrowing from private student loans and credit cards to federal education loans and not increasing aggregate debt or over-borrowing.[48]

The increases in the additional unsubsidized Stafford loan limits should be set at a level sufficient to replace most PLUS loan borrowing, either cost of attendance minus other aid received or a fixed set of annual and aggregate loan limits.

Based on the 2003-04 NPSAS, average annual PLUS loan borrowing was $9,019[49] and the average aggregate for graduating seniors was $16,217. Annual borrowing at the 90th percentile was $17,000 ($11,690 at the 75th percentile) and aggregate borrowing for graduating seniors at the 90th percentile was $36,359 ($19,750 at the 75th percentile). PLUS loan borrowing has increased 25% in the past four years, so current totals are likely much higher. While the average aggregate PLUS loan for graduating seniors falls within the $23,000 limit on additional unsubsidized Stafford loan eligibility for independent students and dependent students whose parents were denied a Parent PLUS loan, the need in any given year may exceed the current annual limits. Moreover, the PLUS loan totals given above are averages; it is likely that more than a quarter of borrowers need to borrow more than the $23,000 limit on additional unsubsidized Stafford loans. These figures also predate the introduction of the Grad PLUS loan on July 1, 2007 and so do not reflect the experience of graduate and professional students who do not receive increased Stafford loan limits if denied a PLUS loan.

Establish an Undergrad PLUS Loan

This is the same as the proposal Leo Kornfeld and Mark Kantrowitz published in the Chronicle of Higher Education in early 2007.[50] That proposal would allow undergraduate students to borrow from the PLUS loan program on their own without parental involvement by inserting "undergraduate student or" before every mention of "parent of an undergraduate student" in the sections of the Higher Education Act that involve the PLUS loan program.

The main flaw with this proposal is that the undergraduate student borrowers would still be subject to the adverse credit history restriction. This would disqualify many from the

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and 5.49%, respectively. According to the President's FY2009 budget, FY2007 PLUS loan default rates were 4.51% and 5.59%, respectively. Therefore the introduction of the Grad PLUS loan program on July 1, 2006 does not appear to have significantly affected the projected life-of-loan default rates for the PLUS loan program.

[48] The opportunity for over-borrowing could be limited by expanding the authority of college financial aid administrators to limit borrowing by their students.

[49] The average is slightly higher at $9,319 for undergraduate students at 4-year colleges. The average PLUS loan broken down by year in school was similar, with $9,640 for freshmen, $9,488 for sophomores, $9,366 for juniors, $8,234 for seniors, and $7,763 for fifth year undergraduate students. However, the percentage borrowing showed a monotonic decrease with increasing year in school, with percentages of 9.4%, 6.5%, 4.8%, 3.3% and 2.4%, respectively. This is likely due in part to the front-loading of grants and lower Stafford loan limits for freshmen and sophomores.

[50] Leo Kornfeld and Mark Kantrowitz, A New 'Independence Day' for Student Financial Aid, Chronicle of Higher Education, 53(23):B11, February 9, 2007.
http://chronicle.com/weekly/v53/i23/23b01101.htm

PLUS loan, leaving them with the same need for additional financing. It also doesn't address the lack of a safety net for graduate and professional students who are denied a Grad PLUS loan. For these reasons the proposal to increase unsubsidized Stafford loan limits would be more effective.[51] However, allowing undergraduate students to borrow from the PLUS loan program would likely save the government up to $1 billion a year, enough for a $250 increase in the maximum Pell Grant.[52]

The shift in student borrowing from private loans to federal loans may negatively impact for-profit colleges by making it more difficult for them to satisfy the requirements of the 90-10 rule.[53] On the other hand, the 90-10 rule will prevent for-profit institutions from raising tuition to match the new loan limits.[54]

Reverse Student Loan Auction and Other Approaches to Injecting Liquidity

Increasing unsubsidized Stafford loan limits and establishing an Undergrad PLUS loan would shift borrowing from private loans to federal loans without addressing the underlying lack of liquidity. For this reason it is important that this proposal be coupled with a proposal for injecting liquidity into FFELP.

The following proposal for a reverse loan auction would not only save the government money, but also address the liquidity issues associated with the turmoil in the asset-backed securitization market. It is based on a proposal posted by Mark Kantrowitz to the FINAID-L mailing list on January 22, 2008.

Instead of cutting costs by reducing lender spread at the top end by accepting bids for a lower special allowance payment, as has been proposed for the Parent PLUS loan rights auction, the federal government should conduct a reverse auction for US Treasury investment in the securitizations of federally-guaranteed student loans. Lenders would bid on the highest cost of capital they would be willing to accept in exchange for the liquidity they need. Since the US Treasury would be providing a limited amount of liquidity (e.g., $20 billion), the lenders would have an incentive to bid higher in order to ensure that they obtained the capital they needed. The US Treasury investment would be allocated in descending order of the cost of capital bids. The premium to be paid would be set in advance by a formula weighted according to the proportion of each credit tranche in the securitization.[55] The lenders would bid the interest rates they would be willing to pay for each tranche, subject to certain minimum bids. The federal government

[51] One could pair the two proposals together, providing an Undergrad PLUS and increased unsubsidized Stafford loan limits for students who are denied a PLUS loan.
[52] One possibility would be to establish an Undergrad PLUS loan open to all eligible students, but restrict the increased unsubsidized Stafford loan limits to just those students denied access to the PLUS loan program.
[53] The 90-10 rule requires proprietary institutions to obtain at least 10 percent of their revenue from sources other than federal student aid. See section 102(b)(1)(F) of the Higher Education Act.
[54] Congress could address this also by choosing to limit the availability of the increased loan limits at for-profit colleges to just those colleges that limit tuition increases to less than the average tuition increase (both amount and rate of increase) at non-profit colleges.
[55] Alternately, the reverse loan auction could be limited to highly rated student loan securities.

would earn the spread between US treasuries and LIBOR plus the bid margin, helping to defray the cost of the FFELP program and further narrowing the differential between the FFEL and Direct Loan subsidy rates.[56] In the event of a default by the lender, the federal government's investment would be secured by the student loan assets, and the servicing of those loans could be transferred to the Direct Loan program. This proposal would not only directly inject liquidity into the student loan market, but also provide a vote of confidence in FFELP securitizations that might jump start the student loan ABS market by increasing demand to match supply.

This proposal is similar to proposals to allow education lenders to borrow from the Federal Home Loan Bank or the Federal Financing Bank or to use student loans as collateral for US Treasuries borrowed from the federal government, since in all of these proposals the government would be investing in securities or bonds backed by student loan assets. However, the reverse auction proposal is superior because it would allow the federal government to receive a higher return on investment. It likewise provides a superior return on investment than the lender-of-last-resort program. The reverse loan auction proposal provides liquidity that the lenders would have to earn, not a handout. It would also be a temporary fix and not a permanent change.[57]

Other possible ideas for providing liquidity to the federal loan programs include:

- Allowing the Direct Loan program to act as a secondary market, buying loans from FFELP lenders at a premium somewhere between the subsidy costs of the FFELP and Direct Loan programs.

- Establishing a program of federal government insurance of municipal bonds, similar to the way in which the FDIC insures bank deposits.[58] This would benefit some state loan agencies by allowing their bond issues to proceed despite the downgrades of their bond insurers.

- Entering into standby loan purchase agreements in which the government would agree to buy the loans (as opposed to the securitizations) if investors were unable to refund the loans. Such letters of credit would be particularly helpful to lenders who are trying to refinance auction rate securitizations into variable rate demand obligations. Such agreements are unlikely to ever be executed, so this could

[56] If Congress were to switch the index on special allowance payments from the Commercial Paper Rate to LIBOR in a cost-neutral fashion, the government's savings from this proposal would be more predictable, since securitizations are pegged to LIBOR.

[57] If education lenders had access to an unlimited supply of low cost capital through the Federal Home Loan Bank or Federal Financing Bank, they would abandon securitization and bond issues as a source of low cost capital. Such a proposal would have to involve either a time limit or set a cost of capital high enough that lenders would eventually switch back to the capital markets when the cost of funds returned to levels close to those in effect before the onset of the subprime credit crisis. Allowing non-bank lenders and nonprofit state loan agencies to borrow from the Federal Home Loan Bank or Federal Financing Bank would require legislative changes that would likely be opposed by banks.

[58] The insurance would insure the payment of interest on the bonds against default by the issuer, not the student loan assets against default by the borrower. The federal government already insures federal student loans against borrower default.

potentially be implemented at no cost to the government, but would provide investors with additional confidence in these financial instruments.

The Direct Loan and Lender-of-Last-Resort Programs

Other approaches to ensuring that federal education loans remain available to students include:

- Retooling the Direct Loan program to permit it to make loans directly to students without requiring the college to formally join the Direct Loan program. This could be implemented through the use of an "alternative originator" as specified in the regulations at 34 CFR 685.102(b) and in sections 451(a), 452(a)(2), 453(a) and 456(b) of the Higher Education Act.

- Streamlining the application process for a school to join the Direct Loan program if the school previously participated in the FFEL program.

- Conducting a quarterly end-to-end realistic test of the lender-of-last-resort program to prevent any teething problems.

Eliminate the Index Rate Mismatch

This proposal would switch the special allowance payments from the Commercial Paper Rate to the LIBOR index in a cost neutral fashion.[59] Historically, the Commercial Paper Rate and LIBOR index have been in sync, only a few basis points apart. It is only recently that the two indexes have diverged. Switching the index for the special allowance payments to the LIBOR index would yield a more predictable spread for lenders who rely on securitization, bond issues and credit warehousing facilities as a source of funds. Eliminating the risk associated with an index rate mismatch would make these loans more attractive to investors.

Monitor FFELP Viability[60]

The US Department of Education does not currently have any tools it can use to monitor the health of the FFEL program. For example, the Department learns about lenders leaving FFELP the same way the general public does, by reading about it in the newspaper. Congress should consider establishing a requirement that education lenders notify the US Department of Education and affected colleges in advance of the lender's unilateral reduction, suspension or termination of secondary market activities or of origination or disbursement activities involving one or more FFELP loan programs at one or more colleges. Ideally the lender should provide at least one month's notice, to give

[59] The average spread between the 3-month LIBOR index and the 3-month Commercial Paper Rate from January 1997 to July 2007 was 7 basis points. So instead of paying lenders the Commercial Paper Rate plus 1.79%, this proposal would pay LIBOR + 1.72%.
[60] Added 3/23/2008.

the colleges time to transition their students to other lenders, but this might not always be possible.

In the meantime, the US Department of Education could use the National Student Loan Data System (NSLDS) to monitor the number of active participants in the FFEL program. For example, it should be possible to calculate the number of lenders originating more than $1 million in Stafford and PLUS loan volume for each month in the last 5 years. One could then calculate year-over-year increases and decreases in the counts to adjust for seasonality. The US Department of Education could also use NSLDS data to identify which lenders are increasing their holdings from lenders that routinely sell their loan portfolios to secondary markets.

Advice for Prospective Borrowers

In the meantime here are a few suggestions for families who are concerned about their ability to obtain financing to pay for a college education.

1. Minimize debt. If you will be borrowing more than your expected starting salary, consider choosing a less expensive college. Live like a student while you are in school so you don't have to live like a student after you graduate.
2. Borrow federal first. Federal education loans are less expensive, more available, and have better terms. The unsubsidized Stafford loan and the PLUS loan are not based on financial need.
3. If you are having trouble finding a lender to consolidate your federal student loans, use the Federal Direct Consolidation Loan Program at loanconsolidation.ed.gov.
4. Wait until July 1, 2008 to consolidate variable rate Stafford and PLUS loans, as the interest rates will drop by about 3% then.
5. If your parents are denied a PLUS loan, talk to your school's financial aid office about getting increased unsubsidized Stafford loan limits.
6. When applying for a private student loan, apply with a creditworthy consigner. Not only does this increase the chances you'll be approved for the loan, but it also decreases the cost of the loan.
7. Focus on private loans that are pegged to the LIBOR index. Loans that are pegged to the Prime Lending Rate will be more expensive in the long term, all else being equal, as the spread between PRIME and LIBOR will grow wider over time.
8. Pay at least the interest that accrues during the in-school period. This will reduce the cost of the loan by avoiding the capitalization of interest. Some lenders offer lower fees for borrowers who pay the interest instead of deferring it.
9. Remember, the unsubsidized Stafford and PLUS loans are available to all students, even those who do not have financial need.
10. Banks are more likely to provide better discounts and lower interest rates and fees than non-bank lenders.
11. Talk to your school's financial aid administrator if you have any concerns.
12. Submit the Free Application for Federal Student Aid (FAFSA) at www.fafsa.ed.gov and search for scholarships for free at www.fastweb.com.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR CASEY FROM JOHN F. REMONDI

Q.1. Secretary Spellings is considering exercising her authority to invoke an emergency safety net that would make the guarantors of federally backed loans into lenders of last resort. It seems that the experimental nature of such a program would make it slow and cumbersome. How will it affect the students that are applying for financial aid to go to school this fall, if at all?

A.1. The least disruptive solution for students and financial aid officers should be geared toward averting a student loan crisis this year. To that end, we support efforts to take budget neutral steps, as outlined in H.R. 5715 or through the U.S. Treasury Department's Federal Financing Bank, to provide student lenders immediate liquidity so the Department of Education will not have to implement its lender of last resort program.

Nevertheless, we support the provisions in H.R. 5715 giving the Department of Education the mandatory authority to advance federal funds to guaranty agencies designated as lenders of last resort. We also support the bill's provision authorizing the Secretary of Education to designate an institution of higher education for participation in the lender of last resort program. As the largest originator and servicer of Federal Family Education Loan Program loans, Sallie Mae stands ready to assist the Department of Education and the nation's guarantors with the implementation of a lender of last resort program. In this economic environment, such action is prudent.

Q.2. As we consider different ways to address the state of these fiscal markets there are a number of proposals, and they all deserve consideration. But I would like to make sure we fully understand this issue. To the extent that you can tell us today, as opposed to the future when we will know more, how much is the current market turmoil temporary, and how much can we expect that in some ways these markets will be changed forever? I ask because, as we consider solutions, we need to be mindful of whether we would be creating permanent Federal interventions when we might only intend temporary ones.

A.2. The financing of student loans is reliant on well-functioning and well priced credit markets, but these markets have been severely disrupted in the past eleven months. Funding costs for student loan securitizations have increased rapidly and significantly during this period. As a result, every federal loan funded in the asset-backed securities market generates a loss even before operating expenses. We are hopeful that the expeditious implementation of H.R. 5715 will send a signal to the markets that the U.S. government stands behind these guaranteed assets and will thus provide more liquidity in the capital markets. Because our business model is based on funding through the issuance of asset backed securities, we prefer to fund our loans through the private capital markets and view a government solution as a temporary one. In fact, the prospects of a solution have contributed to a tightening of spreads in the asset-backed markets. Despite this, current funding costs still mean each loan made is made at a loss.

It should be noted that the reductions in the College Cost Reduction and Access Act will make it difficult for this market to fully recover. The credit market reductions have made clear that the yield on the loans is inadequate to absorb even temporary market disruptions. We look forward to working with Congress to improve the foundation for the FFEL program, to maintain the benefits of competition while assuring that future market disruptions will not threaten the availability of federal loans.

Q.3. There are proposals to allow Federal Home Loan Banks to take some of these securitized loans as collateral and thereby inject some liquidity into the market. Congressman Kanjorski and Senator Kerry have proposals to do that. How does this compare with the other proposals? Do you think the Home Loan Banks would use that authority? And, would such a proposal present any dangers for the Home Loan Banking system at a time when they are already doing so much?

A.3. H.R. 5723 and S. 2847 both authorize the Federal Home Loan Bank (FHLB) system to invest in student loan securities with surplus funds and accept student loan collateral. They also permit them to provide advances to FHLB member banks to originate student loans or finance student loan securities. We view these authorities as important components of a larger long-term solution to the student loan liquidity crisis.

In introducing H.R. 5723, U.S. Representative Paul E. Kanjorski (D–PA), chairman of the House Financial Services Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises, addressed the soundness and safety issue when he stated that "the addition of this temporary power is closely in line with the existing mission of the Federal Home Loan Banks to support community and economic development."

He further stated that H.R. 5723 includes safeguards to ensure that the Federal Home Loan Bank system invests in collateral that is federally guaranteed and carries the highest investment ratings. AAA/Aaa rated student loan asset backed securities which are backed by loans made under the Federal Family Education Loan Program carry a high rating because they are low-risk. Giving the FHLB system these authorities will be beneficial not only to FHLB member banks but to students and borrowers who will benefit by increased access to education credit.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR ENZI FROM JOHN F. REMONDI

Q.1.a. Each of you has emphasized the urgency of the credit environment facing students and families as they prepare for the upcoming academic year. Mr. Remondi, you pointed out that student lending is "seasonal" in nature.

I would like to hear from each of you an assessment of the "point of no return". When does Congress need to act, if it becomes necessary to legislate a Federal response to this issue?

A.1.a. The peak lending period began in April and ends in September. During this time period, more than three-fourth of all loans will be made. As I stated in my oral testimony, Sallie Mae's

new loan applications have increased by 26% in April over last year. At current borrowing rates, lenders lose money on every loan made. As a result, we believe that a gap between available loans and the demand for them could manifest itself at any time.

On May 7, 2008, President Bush signed H.R. 5715, the Ensuring continued Access to Student Loans Act, which would, among other things, give the Secretary of Education the authority to purchase loans from eligible lenders upon the determination by the Secretary that there is inadequate loan capital to meet the demand for loans whether as a result of inadequate liquidity or other reasons.

Sallie Mae supports H.R. 5715 and we are pleased that congress moved quickly to enact it. Because the peak lending season is underway, we are hopeful that the U.S. Department of Education and Treasury will outline and implement a comprehensive plan, that includes immediate liquidity, in the form of federal capital, into the student loan program as quickly as possible so lenders can continue to serve students and schools without interruption.

Q.1.b. Please also consider whether a "sunset" should be attached to these measures.

A.1.b. The Secretary of Education's authority to purchase loans under H.R. 5715 expires on July 1, 2009. It is the hope and expectation of those involved in the student loan market that the capital markets will improve enough by that time to sustain a viable and competitive FFEL program.

Q.2. You each bring a different perspective to the question of how the uncertainty in the credit markets will impact access to student loans.

Could you provide us with an indication of what students may be "hit the hardest" if access becomes a problem this summer? Lower income students? Middle-class students? First-generation students and families? Nontraditional students?

A.2. The unprecedented increase in the cost of borrowing for lenders, the closing of auction rate markets, and the 70 basis point cut in the Special Allowance Payment contained in the College Cost Reduction and Access Act are having an impact on all students. As a result, each new loan made today is made at a loss. The U.S. Department of Education estimates that 7.1 million borrowers will need Federal Family Education Program loans this academic year. So far, lenders representing 20 percent of all originations have discontinued their participation in FFELP. These changes have and will likely continue to affect borrowers representing all socio-economic groups.

Testimony from Trinity College President Patricia McGuire at the April 15, 2008 Senate Banking Committee's hearing on the impact of turmoil in the credit markets clearly demonstrates how students from low-income families could be impacted by any disruption of the delivery of student loans. She stated that: "nearly 90% of Trinity's students today are Black, Hispanic, Asian or international in their immediate family identities, and more than 95% are low-income students who receive substantial unfunded tuition discounts in order to attend Trinity." She stated further that Trinity students "do not have the means to support our students if the federally guaranteed or the private loan programs are jeopardized."

Q.3.a. Thank you Mr. Remondi, for appearing before the Committee. In your capacity as Chief Financial Officer at Sallie Mae, you have unique insight into the interplay of the private education loan market and the government-guaranteed education loan market.

Please provide the Committee with a sense of how the interacting between the private loans and guaranteed-loans in your portfolio affects the services that Sallie Mae offers to students?

A.3.a. Paying for college is one of the most significant financial decisions a family will make. As the leading saving and paying for college company, Sallie Mae takes a comprehensive approach to making college possible for students and families. Our policy is to promote a 1-2-3 approach. Through our Upromise subsidiary, we encourage families to start planning and saving for college early. We urge families to use their personal resources, scholarships and grant money first. Second, we urge that they utilize low-cost federal loans and lastly, only as needed to close the gap between the cost of attendance and available funds, to take advantage of private loans. Additionally, the industry leading services we provide are often directly related to the efficiencies and margins that we can achieve through both federal and private loans.

One of the most important factors in having one lender for both federal and private loans is in the benefit for borrowers and the effect on defaults. It has been a well-established principal of the federal program that borrowers are less inclined to default if all of their loans are with one lender. With one stop, one payment, borrowers are less inclined to miss payments on their student loans.

Q.3.b. Does instability in the private loan market affect Sallie Mae's provision of guaranteed-loan products to students?

A.3.b. Not directly. However, disruption in the private credit-based asset back securitization market has been particularly challenging over the past year. There is currently no market for the securitization of private credit-based loans and several major lenders have ceased making private credit-based loans or insuring them.

Q.3.c. Do cuts in the FFEL program affect Sallie Mae's ability to provide private education loans to students?

A.3.c. Cuts in the FFEL program do not affect Sallie Mae's ability to provide private education credit to students. Our financing lines are distinct for each type of loan. The interest rate for FFELP loans are set by Federal statute while those for private loans are credit-based.

As stated earlier, cuts in the Federal Family Education Loan Program and credit market turmoil have made FFELP loans unprofitable and will affect our ability to continue to make them if a Federal plan to provide capital to lenders is not implemented.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR CASEY FROM TOM DEUTSCH

Q.1. Secretary Spellings is considering exercising her authority to invoke an emergency safety net that would make the guarantors of federally backed loans into lenders of last resort. It seems that the

experimental nature of such a program would make it slow and cumbersome. How will it affect the students that are applying for financial aid to go to school this fall, if at all?

A.1. The Ensuring Continued Access to Student Loans Act of 2008 provides for a mechanism of funding loans that seeks to alleviate the disruptions of the current credit market conditions without having the FFEL lenders seek assistance from the lender of last resort program that was not designed for across the board market disruption. Although this legislation may provide a fix for funding concerns this fall, Congress should consider long-term legislation for future funding seasons that efficiently matches FFEL lenders cost of capital in the secondary market with the rates and special allowance payments that they receive at origination.

Q.2. As we consider different ways to address the state of these fiscal markets there are a number of proposals, and they all deserve consideration. But I would like to make sure we fully understand this issue. To the extent that you can tell us today, as opposed to the future when we will know more, how much is the current market turmoil temporary, and how much can we expect that in some ways these markets will be changed forever? I ask because, as we consider solutions, we need to be mindful of whether we would be creating permanent Federal interventions when we might only intend temporary ones.

A.2. Credit market conditions and the ultimate price that lenders have to pay for capital in the secondary market are certainly higher now than anytime in recent memory. Although numerous steps are being taken by the industry and by banking regulators to improve the confidence in the U.S. capital markets, the cost of capital will always fluctuate appreciably as market forces define the price of that capital. In many funding seasons that cost of capital will be limited to a narrow band, but in some funding seasons such as the one we are currently in, the cost of capital may rise to the point where originating student loans is uneconomical. Longer term fixes need to address these potential cost issues to avoid future disruptions in the availability of student loan credit.

Q.3. There are proposals to allow Federal Home Loan Banks to take some of these securitized loans as collateral and thereby inject some liquidity into the market. Congressman Kanjorski and Senator Kerry have proposals to do that. How does this compare with the other proposals? Do you think the Home Loan Banks would use that authority? And, would such a proposal present any dangers for the Home Loan Banking system at a time when they are already doing so much?

A.3. Proposals that are still outstanding allowing the Federal Home Loan Banks ("FHLBs") to purchase student loan asset-backed securities ("SLABS") could provide some additional liquidity to both FFEL-backed SLABS as well as private loan-backed SLABS. Since FHLBs have not previously purchased SLABS, nor have they made any public statements regarding their willingness to purchase SLABS, it is not clear to what extent, if at all, they would exercise their new authority to purchase SLABS. The Federal Reserve Bank of New York's decision to allow SLABS to be pledged as eligible collateral to the new Term Securities Lending

Facility has provided some much needed liquidity to the secondary market for SLABS. The FHLB proposals could inject additional liquidity into this market, but given the uncertainty of the FHLBs purchasing of SLABS, the extent of that additional liquidity is uncertain/limited.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR TESTER FROM TOM DEUTSCH

Q.1. As we believe Montana student loans are fully funded for the next year—Montana's student lender has secured its financing for the upcoming academic year—does it seem that the existing finance mechanisms will improve in the coming months or do we need to start shifting all student loans away from auction rate bonds?

Should student loan companies feel comfortable using the auction-rate-securities market even if the economy improves?

A.1. Existing finance mechanisms, including securitization, are likely to continue to improve slightly through the summer, but financing FFEL or private student loans in the capital markets would still likely lead lenders to significantly curtail their originations. Although funding spreads have come in by approximately 30 basis points since late March, originators would still be incurring 10 times the capital cost expense compared to their cost of capital from one year ago.

The recently enacted Ensuring Continued Access to Student Loans Act of 2008 ("Act") may provide sufficient capital at reasonable rates for FFEL lenders to meet most FFEL student loan demand this fall. Although the Act provides for assistance to FFEL lenders, the Act does not address the shortfall of private student loan availability that is expected to occur this fall.

Student loan originators have eliminated their use of auction rate securities ("ARS") as a funding mechanism in the current market environment. Given the recent fails in the auctions for outstanding ARS, investor appetite for this product has disappeared. Although the underlying collateral performance of outstanding FFEL loans in ARS is still performing as expected, the performance of ARS in the current liquidity constrained environment has led to a predominant market view that ARS may not be viable funding mechanism going forward.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR ENZI FROM TOM DEUTSCH

Q.1. Each of you has emphasized the urgency of the credit environment facing students and families as they prepare for the upcoming academic year. Mr. Remondi, you pointed out that student lending is "seasonal" in nature.

I would like to hear from each of you an assessment of the "point of no return". When does Congress need to act, if it becomes necessary to legislate a Federal response to this issue?

Please also consider whether a "sunset" should be attached to these measures.

A.1. The Ensuring Continued Access to Student Loans Act of 2008 ("Act") was enacted expeditiously and promises to alleviate a significant portion of the funding concerns for this fall's lending season. Although this legislation may provide a fix for funding concerns this fall, Congress should consider legislation for future funding seasons that efficiently matches FFEL lenders cost of capital in the secondary market with the rates and special allowance payments that they receive at origination.

Q.2. You each bring a different perspective to the question of how the uncertainty in the credit markets will impact access to student loans.

Could you provide us with an indication of what students may be "hit the hardest" if access becomes a problem this summer? Lower income students? Middle-class students? First-generation students and families? Nontraditional students?

A.2. Entering students (i.e. freshman, 1st year graduate students) may be "hit the hardest" because lenders already have made loans to existing students in previous years and have a very strong economic interest in continuing to help fund returning students education to its completion. Borrowers who complete their education are much more likely to pay back the entirety of their outstanding loan obligations. As lenders are having to make difficult choices how to allocate their available capital, given this lending season's current constraints, lenders are more likely to allocate scarce funds to existing students with outstanding student loan obligations to that lender rather than to those who are entering school and don't have preexisting loan obligations from that lender they may default on.

Also, students who are more reliant on private student loans making up the difference between the maximum available from Stafford or PLUS sources and the cost of their education will also be "hit the hardest" because if those private loan funds are not available this fall, those students may simply not have sufficient access to funding to continue or start their desired education.

Q.3.a. In your testimony you have laid out a persuasive case that larger market forces are at work with respect to students and families having access to the financing they need to attend college. Is the Secretary of Education equipped to respond to these disruptions?

A.3.a. The Ensuring Continued Access to Student Loans Act of 2008 provides significant direction for the Secretary to address the current cost of capital disruptions that FFEL lenders are confronting. Although this measure and other steps taken by the Departments of Education and Treasury should help alleviate the capital disruptions this year, I should reiterate that Congress should consider legislation for future funding seasons that efficiently matches FFEL lenders cost of capital in the secondary market with the rates and special allowance payments that they receive at origination.

Q.3.b. To what extent should we leave this to the banking regulators and those with expertise in situations such as these?

A.3.b. The root of the existing difficulty is that if the costs of capital rise to a certain point, FFEL lenders may be faced with originating loans at a loss, given the limit on the rate they are able to charge to students and the limited special allowance payments. Although the industry and banking regulators are actively working to help address current market disruptions and help prevent future market disruptions, the cost of capital for student loan lenders may again be so high that they would face significant losses by continuing to originate loans.

Q.3.c. How should short-term proactive solutions differ from the long-term corrective measures that will restore confidence in our credit markets?

A.3.c. The short term steps taken to address student loan lenders cost of capital difficulties have been targeted and necessary steps to help ensure sufficient access for students to government subsidized loans. Longer term corrective measures to restore confidence in our credit markets should be focused on ensuring institutional investors' have access to the information and risks associated with the securities and the underlying collateral that they purchase.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR CASEY FROM SARAH FLANAGAN

Q.1. It appears that with the tightening of credit standards, low-income students will be disproportionately affected. Can you explain the progression, how this will play out in May or July and later in the year when tuition payments will be do?

A.1. Yes, the tightening of credit standards are likely to affect low-income students. However, several of our members have told us that they think middle-income students will face difficulty as well. (For additional detail see answer to Sen. Enzi's question and the charts above.)

In regard to the student aid process, here is a thumbnail sketch. Most students received their college acceptance letters and student aid award notices by mid-April, at the latest. They then began to make their decisions based on that information, the results of appeals for additional aid, and being placed on acceptance wait lists. Once settled on a college and the final aid package is determined, the institution, based on the student's payment plan for any remaining obligation, will bill the student/family accordingly. Billing could start in late spring or more likely in midsummer in advance of the school year. Students without sufficient grant or federal loans funds to cover their cost of attendance will seek private loans to fill the gap. Most of the private loan applications should be taking place in mid- to late-summer. This is when we will have a better idea if lenders have capital to lend and if so, to whom they are willing to lend.

Q.2. Which students, families, and schools will be impacted first, and what will their options be if they are unable to obtain federal student loans? How will the education section be affected and will they be doing anything to assist low-income students and others

who are denied loans so that the stream of students matriculating to their institutions is not interrupted?

A.2. Our institutions will assist their students to the best of their ability. To a large degree it will depend upon the resources that the institution has to help students. At this point most schools don't know what loans will be available to their students. Only later in the summer will they determine what the need is and if it can be met with institutional resources. At least one state, as described above has established a way for students to borrower from a local bank without a co-signer. If there are delays in the processing of either FFELP or private loans, schools may provide short term institutional loans. (See the answer to Sen. Tesser, question #1.)

Financial offices will work with students and parents to explore all options so students have access to college and can complete their degrees. Colleges have a huge incentive to help current students stay in school and finish. It costs much more to recruit new students than it does to retain current students. And, we know our graduates are responsible borrowers who repay loans. So, the challenge is helping them get through as quickly as possible with as little debt as possible. Attaining a degree is essential to future economic success and personal satisfaction.

Thank you for also asking what the impact could be on our colleges. While it is fitting and appropriate for us all to focus first and foremost on our students, we also must be mindful of the potential negative impact of the credit crisis on our colleges own fiscal health. Most private colleges depend on tuition to survive. We call these schools "tuition dependent." While every college raises charitable funds to supplement the cost of education (Tuition alone does not cover the cost of any college's undergraduate education in this country.), some colleges are more at-risk if enrollments decline than others. As a matter-of-fact, every year several private colleges with long-standing traditions of educational excellence close. The communities in which they are located usually suffer as well when the local college closes.

We are seeing some regional enrollment problems this year. In some areas of the nation, private college enrollments seem to be down, even though this fall's class marks the entrance to college of the largest birth year for the children of baby-boomers (1990). We are closely watching this development to see how enrollments actually materialize in September.

A final aspect of this crisis is the impact on the economic stability of private colleges faced with a demand for increased institutional aid to keep students enrolled. Sometimes when a student reaches a fiscal crisis and a college is out of funded aid, they will simply write off part of the cost (called a "discount"—an industry term for foregone tuition revenue). For many colleges, their discount rate is already stretched to the maximum and we are concerned about their bottom lines if further discounts become necessary because of the credit crisis.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR TESTER FROM SARAH FLANAGAN

Q.1. Has there been real evidence of students not being able to access private label loans in the past few months? If so, do we expect that to continue in the coming months?

A.1. The greatest challenges facing students in the private loan market are new (higher) FICO credit score requirements and requirements for credit-worthy co-signers. While some students may be able to meet these elevated FICO requirement, students with little credit history may not, and low-income students may be unable to find credit worthy co-signers.

Having said that, it is still too early in the loan process to know how widespread overall liquidity problems could be when borrowing actually occurs later this summer. Many problems seem to be regional. Colleges that are most concerned are in areas hard hit by the housing crisis, or in areas in which the economy is weak.

Some of the concern seems to have eased since April. Congressional action in passing HR 5715 restored some confidence in the overall student loan markets. Whether the liquidity that legislation offers federal loans also helps the private student loan markets will be better know by September 1. Also, some lenders are still waiting for the Department of Education's procedural announcements, due by July 1, regarding implementation of H.R. 5715, before committing to further lending this summer.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR ENZI FROM SARAH FLANAGAN

Q.1. Each of you has emphasized the urgency of the credit environment facing students and families as they prepare for the upcoming academic year. Mr. Remondi, you pointed out that student lending is "seasonal" in nature.

I would like to hear from each of you an assessment of the "point of no return". When does Congress need to act, if it becomes necessary to legislate a Federal response to this issue?

Please also consider whether a "sunset" should be attached to these measures.

A.1. As one NAICU member recently put it, "[b]y the time our institutions had real documented evidence, it would be too late for anyone to do anything about it." I think Congress responded prudently to warning signs that students could have trouble accessing both Federal and private students loans. In passing H.R. 5715, Congress has provided a statutory structure to provide liquidity in the federal student loan market. If the remedies in the bill work smoothly it will ease the concern about the availability of FFELP loans. It is not clear whether this will have any salutary, "spillover" effects on the availability of private student loans.

Clearly, we will know more in the next two months. We are just entering the period when students at private colleges begin to apply for private loans for the academic year that begins in August or September. As another of our members recently noted, 'students and their parents will begin looking at private loans after they receive the first bill in early July.' Certainly by early September, or

the beginning of the school year, colleges will know the overall effects on their students.

At this point, some schools are taking a wait-and-see attitude, while schools in other states foresee no problem because their state lending agencies are well capitalized and ready to make private loans, at least for 2008.

H.R. 5715 seems sufficient authorization to address the problems of the present situation, at least on the federal side of the equation. It is too early to tell, if a long-term, or permanent solution, needs to be enacted.

Q.2. You each bring a different perspective to the question of how the uncertainty in the credit markets will impact access to student loans.

Could you provide us with an indication of what students may be "hit the hardest" if access becomes a problem this summer? Lower income students? Middle-class students? First-generation students and families? Nontraditional students?

A.2. In short, a lack of private loans could be a problem for any student who needs a loan and has little credit, poor credit, comes from a family with no credit history, or has parents who are unwilling or unable to borrow under the PLUS loan program. The lack of private loans would probably affect at least some students at every income level.

However, most of our members have indicated they believe low- to middle/upper middle-income students would be the most severely affected since they are the ones most likely to have borrowed in the first place. Interestingly, some of our members think the problem is most likely to hit middle-income families because they tend to have less grant aid than lower-income students. On the other hand, low-income students are less likely to be able to find a credit worthy co-signer.

Parents who refuse to borrow a PLUS loan which allows borrowing up to the cost of attending the institution, put their children in a difficult position. These students must go into private borrowing to make up the difference. Also at risk are middle-income families who have used home equity in the past and may be disadvantaged by the current housing market. If their mortgage has been foreclosed they are not eligible for a PLUS loan.

Below are a set of tables that show the amount of private borrowing by students in various income brackets. These tables are based on 2003–2004 data for undergraduates. This is the most recent data available, but should be reflective of what categories of students have the greatest private loan dependency. I would expect that the highest income students at our private colleges would at this time continue to have the largest private loan debt, as is illustrated in the first table.

TABLE 1. PRIVATE LOANS FOR FULL-TIME UNDERGRADUATE STUDENTS BY AGI AND INSTITUTION TYPE

	Private loans		
	4-year	Public 4-year	Private 4-year
Average Total	7,005.5	5,630.4	8,236.9

TABLE 1. PRIVATE LOANS FOR FULL-TIME UNDERGRADUATE STUDENTS BY AGI AND INSTITUTION TYPE—Continued

	Private loans		
	4-year	Public 4-year	Private 4-year
Adjusted Gross Income (AGI)			
$0–$30,000	5,760.9	4,711.3	6,646.3
$30,001–$75,000	6,861.4	5,649.2	8,092.6
$75,001 or more	8,012.6	6,247.4	9,445.4

TABLE 2. UNDERGRADUATE PRIVATE LOANS BY AGI AND ATTENDANCE STATUS

	Private loans	
	Full-time	Part-time
Average Total	6,283.7	4,686.7
Adjusted Gross Income (AGI)		
$0–$30,000	5,405.1	4,380.2
$30,001–$75,000	6,087.7	5,040.4
$75,001 or more	7,457.8	4,750.6

TABLE 3. UNDERGRADUATE PRIVATE LOANS BY AGI AND DEPENDENCY STATUS

	Private loans	
	Dependent	Independent
Average Total	6,348.9	5,040.3
Adjusted Gross Income (AGI)		
$0–$30,000	5,151.2	5,098.3
$30,001–$75,000	6,045.3	5,086.5
$75,001 or more	7,453.3	4,048.2

Source for Tables 1–3: U.S. Department of Education, National Center for Education Statistics (NCES), 2003–04 National Postsecondary Student Aid Study (NPSAS:04).

Q.3. We have asked institutions to be entrepreneurial in finding ways to partner with private sector in reducing costs to students and families.

At the same time, there are those who are suspicious of preferential relationships, particularly those between universities and financial institutions.

What guidance would you give as we attempt to draw a line between appropriate and inappropriate conduct of institutions of higher education?

A.3. Both colleges and the federal government have been concerned about the area of appropriate activity between colleges and businesses with which they deal. The staff at NAICU have worked with the staff of the House Education and Labor Committee and the Senate HELP Committee to craft an agreeable and effective line between acceptable and unacceptable behavior. We feel that the current sunshine provisions in the draft HEA bill are headed toward that balance. The regulations that the Department of Education published in November, 2007 also aim to control excess while allowing essential training and business activities. No doubt both the HEA and the regulations may need refinements once they have been in effect long enough to see where changes are needed.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR CASEY FROM MARK KANTROWITZ

Q.1. It appears that with the tightening of credit standards, low-income students will be disproportionately affected. Can you explain the progression, how this will play out in May or July and later in the year when tuition payments are due? Which students, families, and schools will be impacted first, and what will their options be if they are unable to obtain federal student loans? How will the education sector be affected and will they be doing anything to assist low-income students and others who are denied loans so that the stream of students matriculating to their institutions is not interrupted?

A.1. Students will be affected in two main ways: initial denial when applying for a private student loan, and subsequent stress when lenders who have exited in the interim refuse to disburse funds. Some lenders are being careful to avoid over-committing their current liquidity. Others are not, and may run out of the funds needed to fully disburse their originations. The affected borrowers will then need to scramble to find replacement funding.

Borrowers who are denied a PLUS loan because of a foreclosure in the last five years are unlikely to qualify for a private student loan. They are also unlikely to qualify for a home equity loan or line of credit, for obvious reasons. They will either have to rely on credit cards, transfer to a less expensive college, or drop out of college.

The greatest impact will be felt by students with bad or marginal credit or a recent foreclosure, low and moderate income students, first generation students, nontraditional students, and students enrolled in 1 or 2 year programs at for-profit and community colleges.

For-profit colleges with large balance sheets are exploring whether they can establish their own private student loans. This will, however, have a significant negative impact on their cash flow unless they shorten the pipeline by selling the loan assets a year or two after the borrowers have graduated (when their credit scores have improved). The elite colleges with large endowments have established financial aid policies that eliminate loans from the financial aid packages of low income students. The colleges in the middle, however, will be in a much more difficult position, as they do not have the endowments needed to cushion a significant disruption to student loan funding. Some of the smaller colleges may be at risk of closure.

If Congress fails to act, lenders representing an additional 20% to 25% of FFELP Stafford and PLUS loan volume will likely exit by early fall, including the largest non-bank lenders.

Q.2. Secretary Spellings is considering exercising her authority to invoke an emergency safety net that would make the guarantors of federally backed loans into lenders of last resort. It seems that the experimental nature of such a program would make it slow and cumbersome. How will it affect the students that are applying for financial aid to go to school this fall, if at all?

A.2. The lender-of-last-resort program has never been tested. It might work flawlessly or it might not. Aside from verbal assurances that it is ready, there is no hard evidence concerning the

likely performance of the system. As with any new program there is the possibility of disruption as any kinks are worked out of the system. It does not take advantage of existing mechanisms in the FFEL program. In addition, the lender-of-last-resort program is a reactive solution that can only be invoked after a crisis has already occurred, yielding the possibility of disruption due to delayed implementation. It does nothing to avert a crisis and does not address the liquidity constraints impacting education lenders. If there is no thawing of the capital markets the lender-of-last-resort program is likely to remain in place permanently.

Q.3. As we consider different ways to address the state of these fiscal markets there are a number of proposals, and they all deserve consideration. But I would like to make sure we fully understand this issue. To the extent that you can tell us today, as opposed to the future when we will know more, how much is the current market turmoil temporary, and how much can we expect that in some ways these markets will be changed forever? I ask because, as we consider solutions, we need to be mindful of whether we would be creating permanent Federal interventions when we might only intend temporary ones.

A.3. Investors in all securitizations, not just student loan securitizations, have become risk averse. They are unlikely to start returning to the capital markets until the subprime mortgage credit crisis has run its course and foreclosure rates start declining. Foreclosure rates are expected to start peaking soon. However, even if the subprime mortgage credit crisis were to disappear tomorrow and investor interest were to return to the levels in early 2007, there is a large backlog of loans waiting for securitization. It will take at least a year and possibly several years for this pipeline to drain. In addition, investor lack of interest in subprime borrowers is likely to be permanent. This means that private student loans are unlikely to start lending to subprime borrowers except to the extent that they are able to identify good prospects among the subprime borrowers (e.g., borrowers who are close to graduation in an employable degree program from a school with a good reputation and high job placement rate).

To the extent that the proposed interventions reduce government costs or increase government revenue, however, permanent interventions aren't necessarily problematic for the federal government.

Q.4. There are proposals to allow Federal Home Loan Banks to take some of these securitized loans as collateral and thereby inject some liquidity into the market. Congressman Kanjorski and Senator Kerry have proposals to do that. How does this compare with the other proposals? Do you think the Home Loan Banks would use that authority? And, would such a proposal present any dangers for the Home Loan Banking system at a time when they are already doing so much?

A.4. Allowing the Federal Home Loan Banks and/or the Federal Financing Bank to invest in student loans or student loan securities and to advance funds for making education loans would be an effective tool for injecting liquidity into the market. However, the Federal Home Loan Banks' primary focus is on mortgages, and so they may be less willing to invest surplus assets in providing liquidity

to FFELP lenders. Such an expansion may be seen as "mission creep" and a distraction from the current mortgage credit crisis (as opposed to the potential student loan credit crisis). There is already some precedent for using the Federal Financing Bank to inject liquidity into the FFEL program (e.g., section 439(h) of the Higher Education Act provided such a facility when Sallie Mae was a GSE). Such an approach might be more stable and streamlined than relying on the Federal Home Loan Banks.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR TESTER FROM MARK KANTROWITZ

Q.1. Will allowing the Federal Home Loan Banks (FHLBs) to invest in student loan related securities, as some have argued for, provide adequate liquidity into the market?

A.1. I do not have any data concerning the total "surplus" assets of the Federal Home Loan Banks, nor their willingness to invest these assets in providing liquidity to FFELP lenders. According to the 2007 Combined Financial Report for the Federal Home Loan Banks, total assets as of 12/31/07 were $1.275 trillion, of which $299 billion was in investments. The FFEL program will origination approximately $72 billion in Stafford and PLUS loans during the 2008–2009 academic year, or about a quarter of the FHLB investments.

Q.2. Are all of the FHLBs able to adequately handle the new line of business as they are grappling with existing capital and liquidity concerns in other areas?

A.2. Allowing the FHLBs to invest in FFELP loans and FFELP securitizations (as well as advances for the origination of FFELP loans) would expand the FHLB mission beyond the mortgage industry. They do not currently have experience in valuing federally-guaranteed student loans. Their attention is also focused on the present crisis in the mortgage industry, and may view the problems in the FFELP industry as a lower priority distraction. On the other hand, there is precedent for having the Federal Financing Bank (FFB) provide liquidity to education lenders, as they did so when Sallie Mae was a GSE. See, for example, section 439(h) of the Higher Education Act of 1965. The FFB can also borrow from the U.S. Treasury.

Q.3. Will permitting the FHLBs to provide secured advances to its members to originate student loans or finance student loan-related securities create increased risk for smaller community banks?

A.3. Federally education loans are already guaranteed against borrower default by the federal government. The added risk of investing in these loans is minimal and consists of a small amount of risk sharing and a kind of prepayment risk when the federal government pays a default claim. The first type of risk stems from the 99% guarantee for lenders who are exceptional performers and 97% guarantee for lenders who are not exceptional performers. Both will be replaced with a 95% guarantee starting in 2012. The second type of risk reflects that a default claim pays only the outstanding principal and accrued but unpaid interest, and not future interest

which would have been collected after the default had the borrower not defaulted.

In the event of issuer default, the newly enacted Direct Loan secondary market provisions of the Ensuring Continued Access to Loans Act of 2008 (P.L. 110–227) would potentially permit the U.S. Department of Education to purchase the loans from the FHLB, returning the capital associated with the student loan trusts.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR ENZI FROM MARK KANTROWITZ

Q.1. Each of you has emphasized the urgency of the credit environment facing students and families as they prepare for the upcoming academic year. Mr. Remondi, you pointed out that student lending is "seasonal" in nature.

I would like to hear from each of you an assessment of the "point of no return". When does Congress need to act, if it becomes necessary to legislate a Federal response to this issue?

Please also consider whether a "sunset" should be attached to these measures.

A.1. As of May 12, 2008, lenders representing 14.1% of FY07 FFELP Stafford and PLUS loan origination volume have suspended participation in those loan programs (17.7% if one counts school-as-lender schools), and 79.3% of FY07 FFELP Consolidation loan volume. The consolidation loan volume is not a concern, not even if 100% of the volume evaporates, as borrowers can currently obtain a Federal Direct Consolidation Loan at *loanconsolidation.ed.gov*. The Stafford and PLUS loan volume, however, is already a concern at schools with shorter 1 and 2 year programs, such as for-profit and community colleges, and at schools with a cohort default rate of 10% or more. Colleges face a significant administrative burden when lenders representing 25% to 50% of its loan volume suspend participation. In addition, when lenders representing a third of the loan volume suspend their participation, the remaining lenders are unlikely to be willing or able to absorb any further increases in marketshare.

There is a need for a sunset provision, as otherwise it might be difficult to wean the FFELP lenders off of a convenient source of low-cost capital. Rep. Kanjorski's bill, the Student Loan Access Act of 2008 (H.R. 5914), includes an adequate sunset provision. In addition, the cost of funds associated with the liquidity should be set high enough that education lenders will return to the capital markets as a source of funding when the cost of funding returns to rational levels, but low enough to ensure continued participation (*e.g.*, between CP + 40 and CP + 80).

Q.2. You each bring a different perspective to the question of how the uncertainty in the credit markets will impact access to student loans.

Could you provide us with an indication of what students may be "hit the hardest" if access becomes a problem this summer? Lower income students? Middle-class students? First-generation students and families? Nontraditional students?

A.2. Students who have been affected by a foreclosure in the last five years, or who have bad or marginal credit, will be the ones most likely to have difficulty obtaining federal PLUS and private student loans. Students who are enrolled at 1 and 2 year institutions are also likely to have difficulty obtaining education loans, as smaller aggregate loan balances per borrower are less profitable for education lenders. The burden will largely be felt by low and moderate income students, first-generation students, and nontraditional students, as they represent a disproportionate share of students enrolling at these institutions. Even at schools with very little subprime borrower exposure, approval rates on private loans have decreased by 10% to 25%. Already students enrolled at foreign non-Title-IV institutions, especially foreign medical schools, are having trouble finding private student loans. This may result in a doctor and nurse shortage several years from now. In addition, private student loans are likely to increase their interest rates by 1.0% to 1.5% or more, affecting all but students with the highest credit scores.

Q.3. You emphasize in your testimony the need to restore investor confidence. Yet here we are, talking about this issue as though the crisis is at hand. There is a difference between being prepared, and creating a self-fulfilling prophecy.

Emergency Congressional action sends a signal. How do we walk the fine line between over reaction, and finding ourselves unprepared?

A.3. FinAid has been careful to use language such as "not yet a crisis", "cause for concern" and "need proactive solutions to prevent a crisis" in order to avoid creating a self-fulfilling prophecy. If Congress enacts legislation that injects liquidity into FFELP, it will be seen as a vote of confidence. To some extent the current situation is a market overreaction and a crisis of confidence by investors in what is still fundamentally good quality paper. It will also restore the balance between supply and demand for student loan ABS, helping to drive down the cost of funds. It also has the potential to provide current investors in student loan ARS with an exit strategy, which might cause other investors to return, jump-starting the auction-rate securitization market for student loans.

ADDITIONAL MATERIAL SUPPLIED FOR THE RECORD

Statement of Dr. Philip Day

President and CEO

National Association of Student Financial Aid Administrators

U.S. Senate

Senate Committee on Banking, Housing, and Urban Affairs

Hearing on Impact of Credit Crunch on Student Loan Market

April 15, 2008

"Opening Doors of Educational Opportunity"

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Mr. Chairman and Members of the Committee. On behalf of the National Association of Student Financial Aid Administrators (NASFAA), I am pleased to offer this statement. I am Dr. Philip Day, President and CEO of NASFAA. Formed more than 40 years ago, NASFAA represents student financial aid administrators at some 3,000 postsecondary institutions across the nation.

Introduction

Our association illustrates the diversity of our higher education enterprise with members from private and public institutions, community colleges, four-year schools, proprietary schools, and graduate/professional institutions. At these schools, NASFAA represents approximately 12,000 financial aid professionals who are dedicated to helping families apply for and receive the funds they need to send their students to college. Each year, financial aid professionals help more than 16 million students receive funding for postsecondary education. Given the complexity of the state, federal, and institutional aid programs, it is necessary to have someone with that kind of expertise guiding students and families through the process. Our members are dedicated professionals who desire nothing more than to provide the needed funds so that our students' dreams are fulfilled with a quality education without saddling them unmanageable debt burdens if we can avoid that, given very tight financial aid budgets available from all sources at our schools.

As the former Chancellor of the City College of San Francisco, I am fully knowledgeable about and sensitive to the reality of the incredible obstacles faced by many students and parents when pursuing their higher education goals. This especially is true for students from low-income families who rely on federal financial aid, including loans, to overcome financial barriers. Troubles in the capital market are threatening students' access to federal loans. NASFAA is concerned that if too many FFELP loan providers leave the program, other banks and non-profit loan providers will not have the capital, capacity, or infrastructure to fill the credit needs for all students. Low-income students, who are the least able to find alternatives, will be the first to face an inability to secure loans.

On behalf of NASFAA I want to express my thanks for this Committee's hearing on the loan access situation; it comes at an opportune time. The peak federal student loan lending season will soon begin. Students and schools need operational solutions in place to avert a potential crisis in federal student loan access. With luck, confidence and rationality may return to the market making moot any need to ever utilize alternative safety nets. But, the potential for an access problem is real and we urge Congress to act to provide any and all safety nets that may be necessary so that no borrower is denied access to a federal student loan.

From our perspective, three safety nets should be put in place to prevent disruption to students' educational plans in the event of a major loan access problem: 1) federal intervention to provide liquidity in the financing markets relied upon by many FFEL lenders; 2) a Direct Loan program prepared to handle a sharp increase in loan volume; and 3) a Lender of Last Resort (LLR) program structured to eliminate administrative obstacles to students.

Liquidity

The first leg of our three-part safety net system is restoring liquidity to the student loan market. Chairman Dodd, it is in ensuring liquidity that your Committee would be most helpful.This Committee has jurisdiction and should report legislation to the Senate floor and shepherd its passage,

clarifying the responsibilities of federal banking entities so that sufficient liquidity is available and no student is denied a federal loan.

The well-reported collapse of the auction rate securities market, combined with other factors, has rendered over 45 FFEL loan providers consisting of 12 percent of loan volume unable to make or purchase new FFEL loans. Action should be taken now to provide liquidity to the loan providers impacted by the collapse of this market. Doing so will not only provide the most seamless solution to assuring loan availability to students this fall, but will also minimize the risks inherent in the LLR program failing or the Direct Loan program being unable to handle volume demands that might be placed on it.

While we (and others) have stated publicly that we know of no student who has been denied a loan to date, we also know that the critical demand for access to such loans occurs in the late spring through mid-summer. For community college students that period could extend through Labor Day. Accordingly, NASFAA has been closely monitoring events and we are very concerned about recent developments. We believe that students' educational plans for this fall could be at risk if corrective steps are not planned, tested, and implemented.

In light of recent events, NASFAA does not believe or accept as credible statements by a variety of officials and observers that suggest a loan access problem is highly unlikely. As you know, a growing number of FFELP loan providers have been announcing suspension or termination of their lending programs, including bank lenders. Every day is seems the media reports more and more lending institutions leaving or suspending federal student loan operations.

Although NASFAA members hope a widespread loan access problem does not materialize and that currently authorized responses to loan access problems, such as LLR and reliance on the Direct Loan program, might meet a loan access problem, it is prudent for Congress to take additional steps to make sure that no student faces disruption to their educational plans due to failures in the student loan programs. It is for this reason that NASFAA endorses additional liquidity being provided to FFEL loan providers that are now unable to secure financing to make new loans due to well-publicized failures in the auction rate securities market.

As you know, Mr. Chairman four different approaches to providing liquidity to FFEL loan providers have been proposed by a variety of parties. Chairman Kennedy has proposed a "secondary market of last resort." Senator Kerry has proposed new authorities for the federal home loan banks to provide immediate liquidity to loan providers and to expedite the restoration of investor confidence in the financing markets. And various parties have proposed that the Federal Financing Bank or the Federal Reserve engage in similar activities.

It is beyond the expertise of NASFAA to sort through these options but we recommend that one or more of them be adopted in order to supplement LLR and Direct Loans as solutions to the problem. In particular, I would encourage you to take a close look at Senator Kerry's bill S. 2847, which might represent the best opportunity to get liquidity to FFEL loan providers who need it in time to meet peak demand for FFEL loans for the 2008-09 academic year.

Direct Loans

The second leg of our three-part safety net system is the Direct Loan program. The Department of Education has assured schools that the Direct Loan program will be a viable option for any institution that is not able to receive FFELP loans. We are also concerned about the logistics of numerous institutions moving *en masse* and quickly to the Direct Loan program while providing uninterrupted service to students. The Department should start the process now of determining how applications for participation in Direct Loans can be expedited, how greatly expanded training opportunities can be created, and how other assistance might be provided to help schools address the human resources, systems conversion, and financial challenges of making a rapid change from the FFEL program to Direct Lending. We understand that the Department is confirming with its Direct Loan servicer that it has sufficient capacity to handle the increased loan volume. Another step may be use in the Direct Loan Program of the CommonLine processing system, which is a set of standard file formats and protocols for transmitting student loan applications and guarantees.

Lender of Last Resort

The third leg of our three-part safety net system is Lender of Last Resort authority found in the Higher Education Act of 1965. Utilizing LLR as a backstop for students who are unable to borrow is an important step to ensuring access to loans. However, we are concerned that LLR is relatively untested, and its requirement that borrowers may need to prove they were turned down by up to two lenders is an additional barrier for students trying to pay for college. NASFAA supports allowing institutions to certify that there is a loan access problem at the institution, so borrowers will not bear this additional burden. We are pleased that Chairman Kennedy has introduced, and his Committee soon will be considering, S. 2815, The Strengthening Student Aid for All Act. We are pleased S. 2815 would, upon the request of a postsecondary institution, allow the Secretary to designate it for participation in their State's LLR program.

Promoting Ethical Student Lending and Wise Borrowing

Mr. Chairman, I would be remiss if I did not again acknowledge your leadership and that of Senators Shelby, Kennedy, and Enzi is promoting new rules to assure ethical marketing of both federal and non-federal student loans. In particular, NASFAA is pleased that major parts of your legislation on this subject have been adopted as Title X of the pending House version of legislation to reauthorize the Higher Education Act. We understand that the conference agreement on this bill is likely to include your ideas. That is good news for student and parent borrowers.

NASFAA also believes that student debt is a problem; everything that can be done to prevent over-borrowing, especially over- and unnecessary borrowing of non-federal loans, should be done. In this regard, I note that NASFAA has proposed school certification of non-federal student loans. We hope this is adopted as part of the higher education reauthorization bill and believe that this provision will represent a small but important step in addressing the student debt issue.

NASFAA notes that Senator Kennedy's bill includes a further increase in the maximum Pell Grant. We enthusiastically embrace this increase. We also support the expansion of unsubsidized Stafford Loans in the bill to enable students unable to secure an affordable non-federal student loan to get at least part of the funds they need from that source. An additional aspect of preventing student over-borrowing is making borrowing less burdensome for parents. We are pleased that Senator Kennedy's

bill includes a provision that would allow parents to defer PLUS loan payments while their student is enrolled in postsecondary education.

Finally, NASFAA supports the ongoing efforts of this Committee to expand financial literacy and education. Anything that empowers young people to deal with the challenges of handling debt and personal budgeting is welcome in an era where these challenges appear to be expanding.

Conclusion

In sum, Mr. Chairman, we congratulate your Committee on holding this oversight hearing and we urge effective and timely legislation be reported to the Senate floor. While we believe we must have in place legislative solutions providing guidance and tools for federal agencies to use to avert any credit crisis, it is NASFAA's fervent hope that such tools may never be used. Indeed, the very fact that the Congress puts into place safety nets may be enough to restore confidence in the federal loan system, making the use of such safety nets moot.

Thank you for considering my concerns and for your Committee's continued efforts in ensuring that student loans are available this fall. I urge you to contact me with any questions or requests.