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Calendar No. 702

110TH CONGRESS, 2d Session | SENATE | REPORT 110–327

PRIVATE STUDENT LOAN TRANSPARENCY AND IMPROVEMENT ACT OF 2008

APRIL 21, 2008.—Ordered to be printed

Mr. DODD, from the Committee on Banking, Housing, and Urban Affairs, submitted the following

R E P O R T

[To accompany S. 2894]

The Committee on Banking, Housing and Urban Affairs which considered the original bill (S. 2894) to establish requirements for private lenders to protect student borrowers receiving private educational loans, and for other purposes, reports favorably the "Private Student Loan Transparency and Improvement Act of 2008" and recommends that the original bill do pass.

INTRODUCTION

On August 1, 2007 the Committee considered a Committee Print entitled the "Private Student Loan Transparency and Improvement Act." The Committee voted unanimously to report the bill to the Senate for consideration.

HEARING RECORD AND WITNESSES

On June 6, 2007, The Honorable Andrew Cuomo, Attorney General, State of New York; Mr. Barry W. Goulding, Senior Vice President, Sallie Mae; Ms. Tracy Grooms, Senior Vice President, Bank of America; Mr. Sevester Bell, Director of Student Financial Aid, Howard University; Mr. Peter Tarr, General Counsel, First Marblehead Corporation; Ms. Jennifer Pae, President, United States Student Association; Mr. Luke Swarthout, Higher Education Associate, U.S. PIRG,; and Mr. Jonathan H. Avidan, consumer, Langhorne, Pennsylvania, appeared before the Committee to testify on "Paying for College: The Role of Student Lending."

69–010

PURPOSE AND SUMMARY OF THE LEGISLATION

The "Private Student Loan Transparency and Improvement Act of 2008" was developed to implement needed reforms in the private student lending market—the fastest-growing segment of the $85 billion student loan industry—and to help ensure that all students wishing to pursue a higher education are able to obtain the most competitive and affordable student loans.

The legislation enhances the transparency and supervision of the private student loan market and includes measures that seek to make the attainment of a higher education more affordable and accessible. Among important provisions in this bill is a requirement that lenders provide more accurate and timely information to their customers about the interest rates, terms and conditions of their products, thereby helping students better understand their financial options and obligations.

The bill contains numerous provisions which promote college affordability by providing student borrowers with a "window" to shop for the best, most competitive educational loan and authorizes federal banking regulators to establish a system to provide financial institutions with credit under the Community Reinvestment Act for making "low-cost" private loans to low-income student borrowers.

The bill also includes provisions prohibiting loan co-branding and revenue sharing.

The legislation contains important new protections under the Truth in Lending Act (TILA) by extending the Truth in Lending Act statute of limitations for private student loan borrowers for a period of one year from the date when their first regular loan payment of principal is due. The legislation also applies TILA provisions to all private student loans, regardless of the amount a student borrows.

Additionally, the bill will promote students' understanding of the private loan market by requiring that the effectiveness of financial literacy programs be evaluated, and that effective programs be promoted.

Lastly, the bill requires that the GAO conduct a study of the impact of the use of nonindividual factors, such as a school's graduation rate, cohort default rate, or accreditation, as part of the underwriting criteria used to determine the pricing of private educational loans to student borrowers and the availability of loan products to institutions of higher education.

BACKGROUND AND NEED FOR LEGISLATION

Private student loans are now the fastest growing segment of the $85 billion student loan industry.[1] Private loans fill important gaps in students' ability to finance college, particularly as federal financial aid has failed to keep pace with soaring tuition costs, which have increased 52% at public institutions and 34% at private institutions over the past decade. As a result, private loans are increasingly becoming a necessity for many families. If current student borrowing trends persist, private loans will overtake federally-guar-

[1] According to the College Board, private education loans totaled $1.3 billion during the 1995–1996 academic year and in academic year 2005–2006 totaled $17.3 billion—an increase of 1,200%. The proportion of private education loans borrowed through banks and other lenders, as opposed to the federal government loans, constituted 20% of all education borrowing in 2005–2006, as compared to 12% five years earlier, and 4% in 1995–96.

anteed lending as the largest percentage of all student lending sometime within the next decade.

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

As the private education loan market grows, so too does the direct-to-customer marketing of loans to student borrowers. Many students who receive direct marketing of private loans may be unaware of the availability of federal loans at lower rates. Student lending advocates have expressed concern that direct-to-consumer student loan marketing may result in student borrowers failing to take full advantage of these lower-cost federal loans before obtaining private loans.

Testimony at the Banking Committee's hearing detailed aggressive and questionable marketing practices and other troubling industry practices, ranging from conflicts of interest to kickback schemes to consumer fraud, that have been unveiled by Congressional and State investigations into the private student loan industry. The Act will help ensure that the rapidly-growing private educational loan market is well regulated and remains accessible and affordable as an alternative source of higher education funding for students who need these loans.

SECTION-BY-SECTION ANALYSIS

Section 1. Short title; table of contents

This section establishes the title of the bill, the "Private Student Loan Transparency and Improvement Act of 2008" and provides a table of contents.

Section 2. Definitions

This section defines "Board," "covered educational institution," "Federal banking agencies," "appropriate Federal banking agency," "institution of higher education," "postsecondary educational expenses," "private educational lender," and "private educational loan" for purposes of the bill.

For the purpose of achieving uniformity and clarity, the Committee sought to cross reference preexisting definitions from other sources in the United States Code.

Section 3. Regulations

This section requires the Board of the Federal Reserve to issue final regulations to implement the Act and the amendments made by the Act not later than 180 days after the enactment of the Act.

Section 4. Effective dates

This section makes the Act and amendments made by the Act effective 180 days after the date that final regulations are issued.

TITLE I—PREVENTING UNFAIR AND DECEPTIVE PRIVATE EDUCATIONAL LENDING PRACTICES AND ELIMINATING CONFLICTS OF INTEREST

Section 101. Amendment to the Truth in Lending Act

This section prohibits lenders from offering gifts to schools or school employees in exchange for preferential consideration of their

private loan products or services. Additionally, this section prohibits private educational lenders from engaging in revenue-sharing and loan co-branding arrangements that use the name or logo of an educational institution. This section also prohibits advisory board members from receiving anything of value from a private educational lender other than reimbursement for reasonable expenses. Prepayment penalties on private student loans are prohibited under this section.

Section 102. Civil liability

This section extends the Truth in Lending Act statute of limitations for private student loan borrowers for a period of one year from the date when their first regular loan payment of principal is due.

Section 103. Clerical amendment

This section updates TILA table of sections.

TITLE II—IMPROVED DISCLOSURES FOR PRIVATE EDUCATIONAL LOANS

Section 201. Private educational loan disclosures and limitations

This section requires private lenders to provide clear and conspicuous disclosures about the terms and conditions of their private educational loans to borrowers at: (1) loan application and solicitation, (2) loan approval, and (3) loan consummation. Among the required disclosures are: the range of APRs applicable to the loan, whether the rate is fixed or variable, any fees associated with the loan, the type of payment deferral options available, and notification of the borrower's eligibility for lower-cost federal loans through the federal financial aid program.

This section provides student borrowers with a 30-day shopping window during which they are able to lock in the terms of a loan for which they have been approved while being able to shop for lower rate products. This section also provides borrowers with a 3-day "cooling off" period after the date of consummation during which the borrower may cancel the loan without any legal or financial obligation on the part of the lender or the borrower.

Section 202. Application of Truth in Lending Act to all private student loans

Applies TILA provisions to all private student loans, regardless of amount.

TITLE III—COLLEGE AFFORDABILITY

Section 301. Community Reinvestment Act credit for low-cost loans

This section authorizes federal banking regulators to establish a system to provide financial institutions with credit under the requirements of the Community Reinvestment Act for making "low-cost" private loans to low-income student borrowers.

TITLE IV—FINANCIAL LITERACY

Section 401. Coordinated education efforts

This section requires the Secretary of the Treasury, in coordination with the Secretary of Education, Agriculture, and other appro-

priate agencies that are members of the Financial Literacy and Education Commission, to develop initiatives to improve student awareness of the cost, obligations, and rights associated with educational loans and other college debts. The Treasury Secretary is required under this section to identify programs and develop initiatives to encourage institutions of higher education to implement financial education programs for their students. This section also requires the Financial Literacy and Education Commission to report to Congress on the state of financial education among students at institutions of higher education.

TITLE V—STUDY AND REPORT ON NONINDIVIDUAL INFORMATION

Section 501. Study and report on nonindividual information

This section requires the GAO to study the impact of the use of nonindividual factors, such as a school's graduation rate, cohort default rate, or accreditation, as part of the underwriting criteria used to determine the pricing of private educational loans to student borrowers and the availability of loan products to institutions of higher education.

REGULATORY IMPACT STATEMENT

In accordance with paragraph 11(b), rule XXVI, of the Standing Rules of the Senate, the Committee makes the following statement concerning the regulatory impact of the bill.

The "Private Student Loan Transparency and Improvement Act of 2008" modifies the Truth in Lending Act to prohibit certain practices by private educational lenders, and to require that they provide additional disclosures to borrowers. The bill requires the Federal Reserve Board to issue regulations to implement the Act. By providing a 30-day shopping window, this legislation should have significant positive impact on students' ability to procure student loans on favorable terms. The bill has no discernable impact on personal privacy. The bill is not expected to result in substantial additional paperwork.

COST OF THE LEGISLATION

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, DC, October 4, 2007.

Hon. CHRISTOPHER J. DODD,
Chairman, Committee on Banking, Housing, and Urban Affairs, U.S. Senate, Washington, DC.

DEAR MR. CHAIRMAN: The Congressional Budget Office has prepared the enclosed cost estimate for the Private Student Loan Transparency and Improvement Act of 2007.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is Justin Humphrey.

Sincerely,

PETER R. ORSZAG.

Enclosure.

Private Student Loan Transparency and Improvement Act of 2007

Summary: The Private Student Loan Transparency and Improvement Act would require firms to follow certain terms and procedures when soliciting or making private loans for post-secondary education expenses. It would direct the Board of Governors of the Federal Reserve and other financial regulatory agencies to issue regulations implementing the new standards. It also would require the Department of the Treasury and the Government Accountability Office (GAO) to prepare reports on issues related to such financial arrangements.

CBO estimates that preparing the reports required by this bill would cost about $2 million over fiscal years 2008 and 2009, assuming the availability of appropriated funds. Provisions in the legislation affecting the workload of the Federal Reserve and financial regulatory agencies would affect revenues and direct spending, respectively, but CBO estimates that any such impacts would not be significant.

This bill contains two intergovernmental mandates as defined in the Unfunded Mandates Reform Act (UMRA). First, it would prohibit public institutions of higher education from participating in certain lending practices and financial arrangements with private lenders. It also would increase the disclosure requirements for lenders of certain educational loans, including public entities. CBO estimates that the aggregate costs to state, local, and tribal governments to comply with those mandates would be small and would not exceed the threshold established in UMRA ($66 million in 2007, adjusted annually for inflation).

The bill would impose a number of mandates on the private sector as defined in UMRA, including increasing the disclosure requirements on lenders that make nonfederal education loans and prohibiting certain exchanges between lenders and institutions of higher education and their employees. CBO estimates that the aggregate cost of complying with those mandates would not exceed the threshold established by UMRA for private-sector mandates ($131 million in 2007, adjusted annually for inflation).

Estimated cost to the Federal Government: For this estimate, CBO assumes that this legislation will be enacted near the beginning of fiscal year 2008 and that outlays will follow historical trends for similar activities. Assuming the availability of appropriated funds, CBO estimates that implementing this bill would cost about $2 million over the 2008–2009 period. Enacting the legislation also would affect direct spending and revenues, but CBO estimates that those effects would not be significant.

Spending subject to appropriation

This bill would direct two federal agencies to prepare reports on issues related to private-sector financing of post-secondary education. The legislation would require the Department of the Treasury to identify and evaluate programs at institutions of higher education that enhance the financial literacy of college students, and subsequently encourage the implementation of those programs that the department found to be most effective. The bill also would require the GAO to prepare a report on the impact of nonindividual factors, such as cohort default rate and graduation rates, on the pricing of private education loans among institutions of higher edu-

cation. That report also would examine the extent to which those factors affect the availability of private loans to certain borrowers or certain schools. Based on information from the affected agencies, CBO estimates that preparing these reports would cost approximately $2 million over the 2008–2009 period, assuming the availability of appropriated funds.

Direct spending and revenues

Under this legislation, the Board of Governors of the Federal Reserve and other financial regulatory agencies would be required to issue regulations and supervise compliance with the new lending standards and procedures in the bill. According to officials at the Federal Reserve and other agencies, those regulatory activities would have no significant effect on their workload or budgets. The budgetary effects on the Federal Reserve are recorded as changes in revenues (governmental receipts). Costs incurred by the other financial regulatory agencies affect direct spending, but most of those expenses are offset by fees or income from insurance premiums. Thus, CBO estimates that enacting this bill would reduce revenues by less than $500,000 in any year and over the 2008–2017 period and would have a negligible net effect on direct spending.

Estimated impact on state, local, and tribal governments: This bill contains intergovernmental mandates as defined in UMRA; however, CBO estimates that the aggregate costs to state, local, and tribal governments to comply with those mandates would be small and would not exceed the threshold established in UMRA ($66 million in 2007, adjusted annually for inflation).

This bill would prohibit public institutions of higher education from receiving gifts from private lenders in exchange for any advantage or consideration provided to those lenders. Those schools also would be prohibited from engaging in revenue-sharing agreements with private lenders. Complying with those requirements could result in lost revenue for those entities. Many schools, however, have stopped such practices voluntarily or as a result of state requirements. CBO therefore estimates that the additional cost to public institutions of complying with the federal mandate would be minimal.

The bill also would increase the disclosure requirements for lenders of certain private educational loans. According to state representatives and industry experts, there are very few public entities that offer such loans and the cost for those entities to comply with the new requirements would be small.

Estimated impact on the private sector: The bill would impose a number of private-sector mandates, as defined in UMRA, on private lenders that make education loans, on private postsecondary educational institutions, and on financial aid administrators and other employees at postsecondary educational institutions. CBO estimates that the direct cost of these mandates would be less than the threshold established by UMRA for private-sector mandates ($131 million in 2007, adjusted annually for inflation).

The bill would prohibit postsecondary education institutions, their officers, and their employees from receiving any gift from a private lender in exchange for any advantage for the lender in its loan activities. Conversely, the bill would prohibit lenders from

sharing the profits from their loan activities with higher education institutions in exchange for some advantage for the lender in its loan activities, including offering or providing gifts to postsecondary educational institutions or their employees. The bill would prohibit lenders from co-branding their loans with the institution's mascot or logo. It would also prohibit lenders from charging prepayment or early payment fees on their loans. CBO estimates that the direct cost of these prohibitions would be minimal, because the prohibited practices are not widespread.

The bill would require lenders to make additional disclosures to borrowers at three stages of the loan application process: (1) with advertising or solicitation of loans, (2) with approval of loan applications, and (3) with consummation of loans. The bill would require lenders to give the applicant up to 30 days following the approval of a loan to accept it with no changes in terms other than via an index to determine the interest rate and to give a borrower up to three days to change their minds once they consummate a loan with a lender. The direct cost of initially complying with these mandates, which would be higher than the continuing cost, would include the cost of the development and legal review of disclosures to be supplied with advertizing materials and the modification and review of other existing disclosure forms. According to industry sources, the major ongoing cost would be the cost of fielding questions from prospective borrowers about the similar but different disclosure forms at each stage of the process.

Estimate prepared by: Federal costs: Justin Humphrey, and Kathleen Gramp and Matthew Pickford; Revenue provisions—Barbara Edwards; Impact on state, local, and tribal governments: Melissa Merrell; Impact on the private sector: Nabeel Alsalam.

Estimate approved by: Keith Fontenot, Deputy Assistant Director for Health and Human Resources, Budget Analysis Division.

CHANGES IN EXISTING LAW (CORDON RULE)

On August 1, 2007 the Committee unanimously approved a motion by Senator Dodd to waive the Cordon rule. Thus, in the opinion of the Committee, it is necessary to dispense with the requirement of section 12 of rule XXVI of the Standing Rules of the Senate in order to expedite the business of the Senate.

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