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# PAYING FOR COLLEGE: THE ROLE OF PRIVATE STUDENT LENDING

## HEARING

BEFORE THE

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

ONE HUNDRED TENTH CONGRESS

FIRST SESSION

ON

ISSUES RELATED TO THE GROWTH AND DEVELOPMENT OF THE PRIVATE EDUCATIONAL LOAN MARKET AND ITS IMPACT ON STUDENT BORROWERS AND THEIR FAMILIES

WEDNESDAY, JUNE 6, 2007

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# PAYING FOR COLLEGE: THE ROLE OF PRIVATE STUDENT LENDING

**WEDNESDAY, JUNE 6, 2007**

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

The Committee met at 10:08 a.m., in room SD–538, Dirksen Senate Office Building, Senator Christopher J. Dodd (Chairman of the Committee) presiding.

## OPENING STATEMENT OF CHAIRMAN CHRISTOPHER J. DODD

Chairman DODD. The Committee will come to order.

This morning the Committee examines the role of private student lending and keeping college affordable and accessible. I want to thank the Attorney General of New York, Andrew Cuomo, and our other witnesses for their appearance here this morning. I can think of no more important topic that this Committee can address at this particular time. Our Nation, our world, is growing more complex and interconnected day by day. Never has higher education been more crucial to the success of our people and our country. If our children are to achieve the highest aspirations and if our Nation's economic backbone is to continue to grow strong, then we must ensure that the financial doors of higher education remain open for all who have the desire and the ability to walk through them.

Today, 60 percent of the new jobs being created by our economy require at least postsecondary education. Compare to half a century ago when only 15 percent of new jobs required some amount of college. Yet, at a time when higher education has never been more important, in a very real sense it has never been more difficult for many families to afford.

Over the past two decades or so, the cost of attaining a college degree has risen at approximately twice the rate of inflation. That is a staggering fact that has imposed a staggering burden on lower- and middle-income families in our nation. Today, the average cost of attending a public university is $13,000 a year. The average cost of attending a private university is more than double that, at $30,000 per year, with some schools, of course, costing as much as $50,000 a year.

As the father of two young daughters, I am not making any plans to retire in the near future here. I was hoping Jack Reed was here to see any advice he might have on this issue with a child only several months old.

During the same period of time, the Federal Government's commitment to student financial aid has waned in relation to the rising cost of a college diploma. Federal aid in the forms of grants and Federal loans has failed miserably to keep up with rising costs. By some estimates, the national gap between the cost of tuition and available aid is approximately $120 billion and growing. This college affordability gap leaves many would-be students with very few options: to give up their dream of pursuing a higher education degree or to rely on their parents for financing their education expenses or to seek out alternative sources of financing of their higher education, primarily through the forms of private education and direct-to-consumer loans.

Unlike the Federal student loans, private loans are not guaranteed by the Federal Government, and while guaranteed student loans carry a rate of no more than 6.8 percent, there are no limits on the interest rates and fees private lenders can charge. Some have variable rates of up to 20 percent. Generally, the underwriting for private education loans is similar to that used for other forms of consumer credit. That means that the student borrowers, who usually have little to no credit history, poor credit scores, or no parental co-signer or whose parents have a poor credit history, will typically pay higher rates than those with good credit histories or those with a parental co-signer with a good history. In some regards, this model runs counter to the longstanding Federal purpose of student aid: targeting low-cost financial assistance to students with the greatest needs and those from the humblest of backgrounds.

Now, that said, there is no doubt that private loans play a very critical and needed role, I would add, in providing students with the ability to finance college. But while beneficial, little is known about the private student loan market. We look forward this morning to hearing more about this at today's hearing, which will focus on an array of issues related to the growth of the private loan market, its oversight, and the role that private lending plays as part of the broader financial aid landscape. I also look forward to hearing more about how private lending practices, products, and services impact student borrowers and their families and hearing from our witnesses about potential areas of concern within the private loan market.

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

The private student loan program is growing at an astronomical rate, by 1,200 percent over the past decade, and private student loans are projected to overtake Federal education loans as the largest percentage of student lending within the next decade. These two charts, by the way, will indicate that first point I made here, give you some idea from 1995 through 2005 of the increase. We do not have the chart here that I should show, by the way, just the increase as well, I mentioned double the rate of inflation of the cost of higher education, which obviously is driving a lot of this. But

again here, the blue and red lines indicate—the red being the private education loans, the blue being the Federal loans, and you see where down the road here those two will cross here, again, relating, of course, to the rise in cost of education. We will leave these around for people to take a look at.

I believe we have an obligation in this Committee to ensure that this market is functioning effectively and efficiently for lenders and borrowers alike. We must act, including legislatively if need be, to ensure that young people in this country and their families have an opportunity to rise as high as their talents will take them without limiting them based on the wealth of their parents or themselves. And we must not let allow young, unsophisticated borrowers and their families to be subjected to practices that would deny them the ability to obtain credit on fair, transparent, and reasonable terms. Otherwise, countless students will suffer serious and irreversible harm to their financial futures, and our Nation's economic and social future will suffer, I would point out, as well.

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

The results of this commitment have been unmistakable and remarkable. In 1955, 3 million young people attended a college or a university. By 1980, that number had risen to 12 million. Today it stands at 18 million, and our Nation's economy during the past half-century has not coincidentally become the strongest and most prosperous in the history of the world. College education is expensive, but if you think education is expensive, as has been pointed out by many in the past, then try ignorance as a cost. Our Nation could ill afford to support its children and their families as they work to achieve prosperity and economic security for themselves and our Nation.

I want to point out here that the other Committee, one of the other committees on which I serve, the Health, Education, Labor, and Pensions Committee, will be marking up the Higher Education Act—I think it is next week, is the plan here. This Committee hearing this morning originally was going to be a joint hearing between Senator Kennedy and myself, combining the two committees because of the joint jurisdiction over the issue of higher education and its cost. Senator Kennedy, as many of you may know, is involved in the immigration bill on the floor of the U.S. Senate, and so he could not take the time this morning to be a part of this hearing.

We are going to focus on, obviously, the lending issues here. The substantive issues involving the Department of Education are a matter we will bring up under the Higher Education Act. But we are anticipating a track here that will allow us to complement that work, and so, again, I appreciate Senator Kennedy's cooperation and the work of his staff and others in working with us jointly, along with Senator Enzi, who is on this Committee, by the way, as well.

But let me turn to my colleague for any comments he has. Senator Shelby.

**STATEMENT OF SENATOR RICHARD C. SHELBY**

Senator SHELBY. Thank you, Chairman Dodd.

Over the past 20 years, the cost of tuition for higher education has increased substantially. Last year, tuition and fees at private 4-year colleges rose almost 6 percent. Funds available to students through Federal Government lending programs, however, have remained largely unchanged since the mid-1990's. And matriculating freshmen can qualify for a maximum amount of $3,500, sophomores are eligible for up to $4,500, while juniors and seniors may qualify for up to $5,500. Graduate students may obtain a maximum amount of $8,500 annually. Clearly, there is a large and growing gap between the cost of tuition and the funds available to students through Federal lending programs such as the Federal Family Education Loan Program, the Direct Loan Program, and the PLUS Program.

As a result, more students and parents are turning to the private market to fulfill this gap. Sources such as home equity loans and lines of credit have been used to meet the needs of many college-bound students. At times, parents and students alike have used credit cards to meet their immediate financial demands. Given the recent reversal in the housing market, accessing homeowners' equity is becoming less of an option for some families. Also, credit cards are rarely the best choice to finance long-term debt. Therefore, more and more students and parents are turning to the private lending industry to make up the difference.

The growth of this industry has been exceptional over the past 10 years. Private lending for higher education accounted for approximately $1.3 billion of student loans originated in 1995 and has since risen to over $17 billion in 2005. Some industry experts believe that by 2009, 2 years hence, the industry will see somewhere between $30 to $50 billion of loans originated annually. I believe this Committee, Mr. Chairman, has a responsibility to examine the private student lending market. We should assess whether there are any shortcomings in existing banking laws or enforcement tools to ensure adequate safeguards are there in place for students.

Because the cost of higher education will continue to climb, I am afraid, we should also make sure that we encourage the growth of private lending and the choices they offer those seeking advanced education. I look forward, Mr. Chairman, to working with you, as always, and learning more about the lending industry from the experts that we will hear from today.

Chairman DODD. Thank you very much, Senator Shelby.

What I am going to do here, Senator Tester has a short opening statement, and Senator Allard, I presume, may make some short comments as well. But Senator Schumer—is that all right with you? I do not want to—let me turn to Senator Tester.

**STATEMENT OF SENATOR JON TESTER**

Senator TESTER. Thank you, Mr. Chairman.

Very quickly, I want to thank you for having this hearing today. I think as you and the Ranking Member have pointed out, college

tuition costs have risen dramatically over the past 30, 40 years, and I am hopeful that this Committee hearing will shed light on the private loans, which are a critical component in our children's ability to get a higher education, and the marketing practices that surround those.

I want to welcome Attorney General Cuomo. I look forward to your comments involving what has been going on in your State as far as the recent marketing practices, to be kind.

And I would just say this: I graduated from college some 30 years ago. My kids are out of school. I am much older than you, Mr. Chairman. I know that. My oldest kid is out of college. She has got a Bachelor of Science in nursing. My parents were able to pay for my education. She had to borrow money to get through. We helped her, but we could not pay the whole thing. My son is a senior in a 5-year program, is on the 5-year plan, and he too is racking up debt. And I think it just takes away opportunity from our kids to be successful when they get out of college.

So I look forward to the hearing. Thank you, Mr. Chairman. I appreciate your indulgence.

Chairman DODD. Thank you very much, Senator.

I should point out, by the way, that obviously myself, Senator Reed, Senator Brown, Senator Enzi, and Senator Allard are all Members of the Education Committee and Members of this Committee as well. So we have a lot of overlap on this subject matter.

Senator Allard.

**STATEMENT OF SENATOR WAYNE ALLARD**

Senator ALLARD. Yes, thank you, Mr. Chairman and Ranking Member Shelby. I would like to thank you both for agreeing to hold this Committee hearing. I think it is important and timely so that we might examine the role of private student lending.

As the American economy has evolved, education has increased in importance. When America was simply an agrarian economy, many people only completed very basic schooling, and academic education was less valuable than practical experience.

Core education and training became more important as the economy shifted to a manufacturing base. In today's highly technological, globally based economy, higher education has become necessary for Americans to remain competitive. In order to succeed in life, people must have strong knowledge and skills, and higher education is one of the best ways to access the opportunities they can bring.

As a veterinarian, I am well aware of the importance of higher education. I could not have pursued my career without undergraduate and graduate studies. More and more people are realizing that their career or lifestyle goals will require postsecondary studies.

Education can require a significant commitment of time and financial resources, though. The Federal Government has created a number of programs designed to make education more affordable, including tax credits, tuition repayment and forgiveness grants, and Federal loans. These options can go a long way in making college more affordable.

Now, private student lending is one additional option to the broad menu of choices available to students and parents in determining the best way to finance an education. Like any option, it may not be appropriate for all circumstances, but for some borrowers, it is the final piece that enables them to attend college or enables them to afford a practical path of study.

As a member of the HELP Committee, I have had the privilege of working with Chairman Dodd on Higher Education Act reauthorization, including student lending provisions. I would also like to acknowledge the work of that Committee's Ranking Member, Senator Enzi, for all his work on student lending. In particular, I have been pleased to work with him on the Student Loan Accountability and Disclosure Reform Act. He has been a strong advocate for fairness, accountability, and disclosure so that students and families can make informed decisions about how to pay for college based on clear, accurate, comprehensive information.

I look forward to this opportunity to get more information on the financial aspects of private student lending, and I look forward to today's testimony.

Thank you.

Chairman DODD. Thank you, Senator, very much.

Senator Casey.

**STATEMENT OF SENATOR ROBERT P. CASEY**

Senator CASEY. Thank you, Mr. Chairman. I will be very brief because I know you want to get to our witnesses.

I want to thank you, Mr. Chairman and Ranking Member Shelby, for calling this hearing. Attorney General Cuomo, welcome to you, and thank you for all your work in this area. And you are being introduced by a good guy there, and I know he wants to say a few words, so I will be brief.

By the way, I did not know that Jon Tester is 30 years out of college. You look great, Jon.

[Laughter.]

Senator TESTER. I will give you some money.

Senator CASEY. It took us about 20 minutes to get to this chair, so we want to be nice to the guy next to us.

Just very briefly, I think what brings us together here—and I would ask that my whole statement be submitted for the record.

Chairman DODD. It will.

Senator CASEY. But what brings us together here is a real concern about what is happening in this market, so to speak. Two trends, really, two regrettable trends: one, cost of college tuition going through the roof—we all know that; but at the same time the failure of loan programs to meet that challenge in the lives of people; and then, of course, the real scandal that we have seen over the last couple of months, if not longer. So we have a lot of questions, and we want to hear the testimony of the witnesses.

I do want to note that on the next panel, from Pennsylvania—and I may not be here for this—is Mr. Jonathan Avidan, who is going to testify and give personal witness to this, tragically so, and I wanted to make sure that I mentioned him.

But we thank you, Attorney General Cuomo, and we appreciate the work you have done, and we are looking forward to your testimony. Thank you very much.

Chairman DODD. Chuck, thank you very much. Senator Schumer is going to introduce our witness, but I just want to say to you, Mr. Attorney General, it is a pleasure to have you back before this Committee. I know you must be having sort of a Pavlovian response here, having spent some time at that table in your previous job as Secretary of HUD, in which you did a fabulous job for this country.

Senator SHELBY. Mr. Chairman, will we get to question Schumer since he is there?

[Laughter.]

Chairman DODD. No, I will step in. I will defend you, Chuck. I will not allow any questions—unless you want to answer them.

Senator SCHUMER. Remember the Woody Allen movie "Bananas" where he sat here and he was the witness, he testified, and he was the lawyer, and he kept going back and forth?

[Laughter.]

I am not going to do that, I assure you, my friend.

Chairman DODD. Well, anyway, Andrew, first of all, I have been a personal friend, and I have a high regard for you, and I am delighted you are here this morning, and we all admire what you have been doing over the last number of weeks and months here on this very, very important issue. So it is highly appropriate you are here. We thank you for offering to come before us and share your thoughts and ideas on how we can do a better job here on oversight, and also looking at the possibility of some legislative activity here to better manage a very, very important issue, a critical issue for America's well-being.

So, Chuck, why don't you go ahead.

**STATEMENT OF SENATOR CHARLES E. SCHUMER**

Senator SCHUMER. Well, thank you, and I want to thank you, Mr. Chairman, for having this hearing. We have had a whole series of timely hearings on a whole bunch of other issues, and your leadership on this Committee is greatly respected and needed. I want to thank Ranking Member Shelby, who did the same thing when he was Chairman, and I want to welcome all of the witnesses here today to testify on this important issue.

I am pleased to be here to introduce the 64th Attorney General of my home State, the Honorable Andrew Cuomo. The Attorney General is here today, of course, to talk about the investigation he has spearheaded to shine light on the practices of the student loan industry and its partners. Thanks to his efforts—intelligent, thoughtful, unfailing—universities and colleges across the country are now entering into a voluntary College Loan Code of Conduct to ensure that their students are being offered a fair deal to fund their education.

Attorney General Cuomo has a long and illustrious record of fighting on behalf of New Yorkers and Americans. A native New Yorker, he attended two proud New York institutions—Fordham University and Albany Law School. He began his legal career as an assistant district attorney in Robert Morgenthau's fabled D.A. of-

fice, and then served at the firm of Fried, Frank, Harris, Shriver & Jacobson.

In 1986, Mr. Cuomo founded Housing Enterprise for the Less Privileged, well-known across the country as HELP, which quickly became the Nation's largest provider of transitional housing for the homeless. Its innovative model led to his appointment to the New York City Commission on the Homeless by former Mayor Dinkins.

In 1996, President Clinton, as you mentioned, Mr. Chairman, nominated Mr. Cuomo to serve as Secretary of HUD, where his key focus became fighting racial discrimination. As HUD Secretary, he brought over 2,000 antidiscrimination cases across the country and successfully led 400 mayors and local law enforcement in a coalition to help fight gun violence. His work as HUD Secretary earned him the prestigious Innovations in American Government Award from the Ford Foundation and the Kennedy School of Government.

In addition to being a dedicated public servant, he is the father of three beautiful daughters—Mariah and Cara, and the youngest, Michaela—and they are cuties. They are great little kids, and I love to see them at the events where we bump into one another.

So, Mr. Chairman, I thank you for allowing me to introduce my friend and colleague in Government, and I know the Committee looks forward to hearing his testimony. However, before we begin, I just want to touch on the issue at hand, the focus of today's hearing: the role of private loans to pay for higher education. As you have mentioned, Mr. Chairman, college degrees are essential to the success of our children, also our country. Enrollment in higher education has increased from 3 million to 18 million. The United States has fallen to number 7 on the list of developed countries with the highest graduation rates. We used to be number 1 or 2. And the problem in higher education, by and large, is not quality. We are still way up there in terms of quality. Our K through 12 is not, when you look at the developed nations. But it is cost. And to maintain global competitiveness, we need to ensure our students and their families have the ability to pay. Tuition is skyrocketing. We all know that.

In the past year, two out of three students have had student loan debt, up from less than one-half in 1993. My experience is the same as Senator Tester's. My parents probably on an economic basis certainly had less money than I did—than, you know, my wife and I earn, but they were able to pay for all their kids' college and graduate school educations. We cannot. And I have two daughters—one starting college, one starting law school—and we are looking into the loan program as a consumer. Now, I can tell you, it is confusing and it is difficult as you go through it.

Over the past decade, debt levels for graduating seniors have more than doubled, from $9,000 to $19,000. That is a 58-percent increase. And the rising student debt can affect a student's livelihood. For decades after graduation, kids are not able to pursue the profession they want because they have all this debt hanging over their head, and they go do something that enables them to repay the loans. They might delay the purchase of a home or a car. They are discouraged from starting an earlier family. It has all kinds of ramifications way beyond just paying the loan back.

So what is the answer? There are a lot of answers, but one that I would hope this Committee would focus on is just clearer disclosure. There may be other things we should do. It is confusing, as I said, as a consumer going through this now. And one of the reasons that kids get taken advantage of is that the competition is not there because it is so confusing.

Good old-fashioned American competition is the great antidote here. And if people understood the varying costs and complications and just my experience, you not only have to look at the interest rate, you have to look at when the interest starts accumulating. You have to look at the points and fees. You have to be almost a math genius to figure out the different programs, and as Andrew Cuomo has admirably shown, many colleges and institutions steer you to one lender, and that sort of eliminates competition from the get-go. Andrew just told me that about 90 percent of the students go to the place that is recommended by their institution.

So one thing we might consider is something that, as you know, Mr. Chairman, throughout my career in the House and the Senate I worked on, disclosure, we have a Schumer box for credit card applications. It is simple. Everyone can compare what the interest rate is. Everyone can compare the three things, and, in fact, Secretary Bernanke just made some changes. We ought to have a similar box, a similar Schumer box, for loan application packages so that people can understand and compare. And if the college says do this one but you can look at another private loan and it is cheaper, you will be able to see it quickly and easily, and you do not have to hire a Ph.D. in mathematics to figure out which loan is cheaper, because it is not as cut-and-dried as you might be.

So I would hope, Mr. Chairman, one of the things we can do—and I know under your capable leadership we will pursue every aspect that this Committee has jurisdiction on in this—is look at disclosure, make sure it is simple and fair. Make sure prospective loan applicants can just compare the basic programs and see how much they pay, without much duress, and making that sort of like we did in credit cards in a simple box-like form on every application I think would be a good start.

With that, I want to thank the Attorney General for being here again.

Chairman DODD. Thank you, Senator Schumer, very, very much, and thank you for your statement.

Mr. Attorney General, welcome. Thank you for being with us. We will include your statement and any supporting evidence or documents you think would be worthwhile for the Committee to have as well, and that will be true of all of our witnesses. Go ahead and proceed.

## STATEMENT OF ANDREW M. CUOMO, ATTORNEY GENERAL, STATE OF NEW YORK

Mr. CUOMO. Thank you very much. First, it is my true honor to be introduced by Senator Schumer. He is a great U.S. Senator, but he is a New York treasure, and we take special pride in watching the great work the Senator is doing. I have had the good fortune to work with him for many years, and it is a true pleasure to work with him on this very, very important issue.

Chairman Dodd and Ranking Member Shelby, it is a pleasure to be back before the Committee. As you mentioned, I was HUD Secretary so I spent 8 years testifying before the Committee. The chair does not seem as warm as it was when I sat in it as HUD Secretary. So it is a pleasure to be back. And as the Members of the Committee have pointed out, it is a very, very important issue indeed. It affects families all across the United States. It is one of the most precious assets that we are trying to protect. And I believe in this case with the student loan issue, Government has really hit students and their families with a real one-two punch.

First, as has been pointed out, Government student aid has not even come close to keeping pace with the rising cost of college. If a student or their family cannot self-finance this enormous cost, they must enter the private loan market.

The second punch lands when the Federal Government fails to police that marketplace. After pushing students into the arms of private lenders, the Federal Government has failed to ensure that those lenders operate ethically and legally and has allowed students to be victimized.

There has been much discussion about the Department of Education's failure to police these rampant abuses. If jurisdiction is the issue, then where were the FTC and the OCC and the FDIC? In my opinion, it is a double debacle of Government failure, an alphabet soup of acronyms that have failed to do their jobs.

The private loan arena is growing exponentially. It is now over 20 percent of the market. Why? Because that is where the money is. Private loans are big business. Let me give you an example of the high cost of these private loans. One private lender, for example, markets private student loans at interest rates as low as 7 percent, yet over 40 percent of its loans are at interest rates of 10 to 16 percent. Some loans go as high as 19 percent. Only 17 percent of the lender's loans are actually at rates between 6 and 8 percent. And let us not forget that the interest rates on these private loans are variable, meaning they may significantly increase over time.

I urge this Committee to ask a very simple question to the private lenders: What are your rates and at what colleges? I think you will be surprised by the answer.

The worst practices we have seen in the college loan investigation came out of this sector of the student loan business. It is the Wild West of the college loan business. Most of the troublesome activities that schools and lenders have engaged in focus on what is called "preferred lender lists." These are the schools' lists of recommended lenders. The benefits to being on a preferred lender list are powerful. As Senator Schumer mentioned, 90 percent of the students follow the recommendation of the school; 90 percent of the students take one of the "preferred lenders." Why? Because the students trust their schools. This is not a normal consumer transaction. When the school recommends a preferred lender, it carries significant weight in the recommendation. And the worst practices and inducements offered by lenders are about getting on these preferred lists in the private loan arena.

Let me describe some of the worst practices we have seen in this area.

Revenue sharing, and we believe this is the most egregious practice that we have found. This practice was exclusive to the private loan sector because it is specifically illegal in respect to Federal loans but not in private loans. In revenue-sharing arrangements, the lender pays the school a set percentage of the student loan volume. These revenue-sharing arrangements are essentially undisclosed loan brokerage schemes. In my opinion, they are no better than illegal kickback arrangements found in other industries and they should be banned.

Perks to school financial aid officers—expensive meals, travel to attractive locations, conferences in attractive locations, tickets to entertainment events, honoraria to serve on lender advisory boards. In some instances, financial aid officers even held stock in the lending companies that they were recommending to students.

We have also found numerous other benefits to schools, including lender-funded printing of materials, lender-run call centers, co-branding of lender materials using the school's logo, improper use of sweepstakes to get students to take loans, and leveraging of opportunity loans.

There are also significant rate disclosure issues, as Senator Schumer points out. Amazingly, although lenders advertise their "as low as" rates, students often do not get the actual rate until the time the loan is being signed up. Financial aid officers who do not even know what the rate is going to be suggest preferred lenders without knowing the rates.

How did this happen? Because the Department of Education claims that they were unable to regulate this sector, and because the Department of Education did not refer the problems to the Federal banking and consumer regulators, such as FDIC, Federal Reserve, OCC, OTS, as well as the FTC.

The Federal banking regulators, by the way, could have addressed the problem without any referral, but they did not. Interestingly, while all this has occurred, my office has still not heard from a single Federal regulator. Even more interesting, I believe, is that all the actions we brought in the Attorney General's office and other Attorneys General are bringing all across the country could have been brought by the OCC or the FTC if they wanted to bring these actions.

The good news is that as my office has exposed these illegal practices, consumers and the industry have heard the problems, and they are responding. Consumers are demanding reform, and schools and lenders are actually willing to change course and set a new industry standard. To that end, we have entered into numerous settlement agreements with seven major lenders across the country, all from the private loan sector, and 25 schools in which they adopted a new College Code of Conduct. And this is before the Federal Government has even acted.

So where are the Federal regulators? Well, just last week, the Department of Education issued new proposed regulations in the spirit of addressing this problem. These regulations, however, are still inadequate, in my opinion. They still allow some perks to be dangled before financial aid officers, and they do not make it clear that when a school picks a preferred lender, that decision should be in the best interest of the student, period. We passed a law in

the State of New York called SLATE, which would do just this. But I believe in the Department of Education rules, there is still a gaping hole.

Finally, the regulations do not and, according to the Department of Education, cannot extend the Department's supervision to the private loan sector. This is not a defense. If the Department of Education cannot regulate the private loan market, then why not refer these actions to the appropriate banking and consumer protection regulators, such as the FDIC, the Federal Reserve, OCC, OTS, as well as the FTC? And why can't the Federal banking regulators do their job unprompted?

In a nutshell, we suggest increasing the Federal student aid to keep pace with the cost of college and to having the Federal Government perform its function as a regulator and protector of the American consumer. The Department of Education was asleep at the switch, but so were the banking regulators, who must now also awake and act. This is, as the Committee has pointed out, a far greater than purely economic issue. It is a moral issue. It is more than just dollars and cents. If we believe in the American dream of higher education for all its children, then we must do far better. We must ensure that the students can afford the dream without becoming enslaved in a nightmare of long-term debt.

The good news is I believe we have an opportunity here, Mr. Chairman. We have disclosed the problem. We have disclosed the solutions. Students are crying out for help. Colleges and lenders are saying they are ready to reform. We just need the political will now for Government to act, and hopefully with the leadership of this Committee we will.

It is my pleasure to be before you, and anything I can do to be of service, I will.

Chairman DODD. Well, again, congratulations on your fine work in this area, and actually you end on a good, encouraging note as well. I was delighted to hear and read the other day about a number of the lenders as well as the institutions stepping up and offering to accept certain guidelines. Our intention would be here as well to take a look at clearly what we might be able to do legislatively and try and marry that with the Higher Education Act moving forward so we can complement the efforts there that need to be practiced.

Senator Shelby and I were mentioning here something that I presume you are aware of. In fact, you may have mentioned it already, but under the Real Estate Settlement Procedures Act, RESPA, which you are very familiar with, they prohibit kickbacks under the law in the mortgage industry. And I guess the simple question I would ask is: Shouldn't a similar provision be included when it comes to students loans?

Mr. CUOMO. Mr. Chairman, and as Ranking Member Shelby knows, it is a very interesting parallel to me. The student loans, I think, at one time were much smaller in terms of volume than a home mortgage, so they never received the same level of scrutiny or regulation. Student loans now rival home mortgages. In some families, the student loan indebtedness is higher than the home mortgage. But if you look at the way we regulate the home mortgage industry—the disclosure, the transparency, the definition of

relationships—it is not even close. The home mortgage transaction is a much safer, better regulated, consumer-friendly transaction than the student loan industry. RESPA, the RESPA laws, the disclosure of the role that you are serving, disclosure of fees, disclosure of kickbacks, is a much more protected loan system than the student loan system. And I think if we just replicate what we did in the home mortgage system, we would greatly enhance the student loan system and the protections for consumers.

Chairman DODD. You know, let me draw upon your earlier experience as well. I could not help but think, in anticipation of your presence here today, we have had a lot of discussion over the years, certainly during your tenure at HUD, about redlining in a sense, where entire neighborhoods and so forth would be treated differently than others based on the assumption that there were going to be higher default rates in those communities or parts of those communities.

One of the concerns I have here is that we are looking at, in some cases here, anyway—and I would like you to comment on this—that institutions are being sort of in effect redlined when it comes to student loans based on the economic status of the parents or the families of the children who attend these institutions, rather than looking as to whether or not the individual student is going to be in a position to meet the obligations under the loan at all.

Tell me what you discovered or what you are finding in regard to that and what recommendation you have. We are going to have witnesses here this morning from some schools that I suspect—I do not know this, but I suspect that overall the financial status of the families there are going to be less than they would be at some of the Ivy League schools in some cases, and whether or not those students ought to be discriminated against based on the fact that they come from families that are less well off and thus are denied the opportunity to get some of these loans.

Mr. CUOMO. Mr. Chairman, it is an excellent point, and I think it is a helpful parallel to remember the home financing system, the mortgage system, when we are thinking about student loans. And you will see on the student loan side that competition is nowhere near as productive, the disclosure, the transparency, the fees, the relationships are nowhere near as transparent and clear to the consumer. And we just—and I want to be careful what I say because we have recently commenced an investigation into exactly what you have just inquired about—the underwriting of these loans. And on the home finance side, the redlining suggested that by virtue of just being in a geographic area, the borrower may be put in a different situation. And on the home finance side, the mortgage side, we are familiar with what criteria are allowed in underwriting and what are not, what are the civil rights ramifications of using certain criteria in mortgage underwriting.

We are now looking at the same on the student loan side. What criteria are they using in doing the underwriting of student loans? Parental income in the case where the parents are actually signing or co-signing the loan. Student income, student creditworthiness.

How about the school that you attend? And are different schools weighted differently in the underwriting criteria? If I go to Harvard, is that one score versus going to a public school? If I go to

a historically black college, how do you weigh that, if at all, in the underwriting criteria?

And we are investigating that now in the Attorney General's office. Of course, a financial institution has a right to make the determination as to creditworthiness and scoring and FICO scores, et cetera. But there are also civil rights and legal ramifications to what criteria they are counting, and that is what we are now looking at.

Chairman DODD. Well, good. I encourage you to do that, and we want to take a look at that as well. In fact, I will raise that issue with some of the witnesses who will come after you.

Last, before turning to Senator Shelby, you mentioned here you have not heard back from any Federal agencies at all. That is disturbing to me in light of all the news around this and the obligation here, at least one would think, the interest being raised about what either existing law would allow Federal agencies to engage in, what practices they could examine, and where there may be a legitimate area even by regulation or by statute to expand our involvement.

Expand on that a little bit further. You have heard from none of these agencies. You mentioned the FTC. Who else would you have assumed to have heard from? And what other Federal agencies do you think should be stepping up or at least expressing some interest in this matter?

Mr. CUOMO. Well, Mr. Chairman, first, my premise is that the actions that we brought, the actions that other Attorneys General are bringing, they could have all been brought by the Federal regulators. My reading of the Federal Trade Commission Act clearly speaks to jurisdiction to protect consumers in unfair transactions, deceptive practices. It is what the FTC could be doing. I believe the FDIC also has jurisdiction, and the OCC. And we have heard from none of those agencies, not even inquiring, and a lot of the actions we have brought are involving Federal institutions.

Chairman DODD. Have you communicated with any of them at all yourself, any correspondence or any inquiries from your office to theirs, or just not hearing back?

Mr. CUOMO. We have been communicating with the Department of Education, but we are now going to be contacting the Federal regulators also, because it is ironic in some ways, there is a separate discussion on the issue of preemption where the Federal regulatory argument is you do not need these State AGs doing consumer protection because the Federal regulatory agencies already have that legal jurisdiction and that mandate, so why confuse it with these State Attorneys General running around?

Well, if that is the theoretical position—and I believe it is a reading of the law. The FTC could have brought these actions. But they did not. Why didn't you? And even when you are on notice, why didn't you? And even when the Department of Education had all sorts of information and Inspector General reports about these circumstances, why didn't you act? And if you are not going to act, well, then, why not allow the AGs across the country to act and fill a vacuum when you are leaving it? And it is clear that there are voids and there are vacuums.

So I believe they have the jurisdiction. I believe they did not exercise it. I believe that from the Federal Government's point of view, this is not the situation by the old expression where the left hand did not know what the right hand was doing. I think that it is a situation where the left hand did not know what the right hand was not doing. If the Department of Education cannot do it and they do not have jurisdiction, then the banking regulators should have been doing it.

Chairman DODD. Thanks very much.

Senator Shelby.

Senator SHELBY. Attorney General Cuomo, we mentioned RESPA a minute ago. You know a lot about it. You served as HUD Secretary. We dealt with you. Senator Allard was very involved in this and, Senator Dodd will recall, in stopping that proposed regulation change where there would not be full disclosure of where fees went and so forth. They could lump things together and they could do different things, and Senator Allard was very involved when he was Chairman of the Subcommittee in that area then.

Some of us thought, my gosh, why do you want to create something and not have full disclosure? What we tried to do, as I understand, we tried to create conditions in Government, make public policy where the public, the consumer, will know what they are getting to try to eliminate conflicts, and I commend you for what—and people that are getting kickbacks in one form or another. They are never called kickbacks, but, you know, we know what—and if we can do this and you are in the forefront of it, I think it is for the good. But the average person needs a level playing field.

I want to ask you this. We deal with the banking regulations here and jurisdiction, Senator Dodd. The Truth in Lending Act presently governs most student lending. Is this law appropriately tailored for this kind of lending, in your judgment? In other words, does it work better for, say, credit cards than private student loans or so forth? You understand what I am getting at.

Mr. CUOMO. Yes, I do.

Senator SHELBY. In other words, is this something that we need to look at from this perspective on the Banking Committee?

Mr. CUOMO. It is a good question, Senator. I believe this is not a case where you need new law and new regulations to give the Federal Government the authority that they do not have. I believe they had the authority. I believe they did not exercise it. I believe it would be appropriate to spur them to act or clarify the law or the regulation. But I do not believe it is a question of creating new jurisdiction——

Senator SHELBY. They do not need any new laws. They just need more action.

Mr. CUOMO. They need more action.

Senator SHELBY. OK.

Mr. CUOMO. And when you compare this, Senator, to the conversations we have had on RESPA and all those conversations about disclosure, the lack of disclosure here, it is not even a comparable conversation. We have disclosure on the mortgage side that has gone so far, is so protective, that is where I come up with the expression this is the "Wild West" compared to the mortgage side. You have colleges making recommendations, 90 percent of the stu-

dents are following them because it is not even a normal marketplace transaction. People believe the school.

Senator SHELBY. And people are making money off of those recommendations.

Mr. CUOMO. They are making money. They were revenue sharing as they were getting a commission. It was undisclosed. It was a significant amount of money. We did a settlement with one school where we made them return the commissions, $500 per student. None of this would be close to legal, I am——

Senator SHELBY. Didn't some of them have stock in some of the deals, too?

Mr. CUOMO. Some of the financial aid officers actually had stock. There is no competition in the industry. Once you are on the preferred list because of your relationship, you are on the preferred list. And no one else can get on that preferred list, so you are not even allowing the marketplace to work where they could compete against each other, get the rates down, so the students would have the benefit of the competition.

Senator SHELBY. Mr. Attorney General, it would be helpful for us here in our oversight if you could share with us any specific instances where lenders have violated Federal banking laws so that we can focus our oversight efforts? As you said, the laws are there. It is a question of enforcing the laws. The regulators and others are supposed to enforce the laws. We are going to do our oversight, but you can help us in that regard.

Mr. CUOMO. It would be my pleasure, Senator, but I do not believe——

Senator SHELBY. If you would furnish this for the record, and our staff would be——

Mr. CUOMO. It would be my pleasure. But just as a general statement, Senator Shelby, I do not believe there is an action that I have taken that the Federal regulators could not have taken.

Senator SHELBY. OK. Thank you.

Thank you, Mr. Chairman.

Chairman DODD. Yes, Senator Tester.

Senator TESTER. Yes, thank you, Mr. Chairman. I want to thank Ranking Member Shelby for his questions because I think whether we have to change the policy or not or whether it is ineptness in the bureaucracy I think are important points to make.

I would ask you, Attorney General Cuomo, why you think that they did turn a blind eye to this issue of consumer protection for our young folks. But my guess is it would just be supposition, unless you know.

Mr. CUOMO. Senator, it is an interesting question, and the evolution of this situation is interesting. This market has grown very quickly. The rate of growth on this private loan market—which has really been established to fill this void. The college costs went up. The Government student loan programs did not go up. You came up with a gap. Someone had to fill that gap. The private loan market expanded very rapidly to fill that, with very little specific regulation. So then the market overheated, the market competed, and it became a situation where everyone was being entrepreneurial, and they were pushing the envelope, in my opinion. And one of the lines I have heard over and over again is, "Well, everyone was

doing it." So since your competition was offering a certain perk, you had to offer a better perk if you wanted to compete. And that fed on itself, and the regulators did not step in.

In that case, it is a classic situation where an overheated private market without appropriate governmental regulation can abuse consumers, and it did.

Senator TESTER. How did you find out about—who gave you the information by which you took the initiative to find out what the heck is going on in this marketplace?

Mr. CUOMO. Well, you know, Senator, I wish I could come and say that my office was prophetic on this. Actually, the issue has been out there for quite some time, and there have been congressional sources that have been looking at it; other AGs have been looking at it.

Senator TESTER. So it is something the bureaucracy should have known about and did probably know about.

Mr. CUOMO. Oh, yes. No, there was no secret here.

Senator TESTER. OK. I am just curious. Your best guess, the percentage of higher education, private and public, that are doing the revenue sharing and the perks and, you know, a lot of stuff that is not quite square, do you think it is all of them?

Mr. CUOMO. On the private loan side, it is rampant, because you almost had to, if you were going to compete. If I am a private loan officer and I am offering a financial aid officer a conference in the Bahamas, well, then my competition is going to have to do something else. If I am offering the school 1 percent of the loan volume, then the competition is going to have to work against that bid. And that fed on itself, and it overheated, and no regulator came in and said, "Slow down. Let us look at the law here."

Senator TESTER. Well, I just want to make just a final comment. I really appreciate your work on this issue, and I appreciate your testimony here today to bring it to our light, and hopefully that will not be the last we hear about this issue, and I am sure it will not. Thank you, Attorney General Cuomo.

Mr. CUOMO. Thank you, Senator, for your kindness.

Senator TESTER. Thank you, Mr. Chairman.

Chairman DODD. Thank you.

Senator Allard.

Senator ALLARD. Thank you, Mr. Chairman.

The Federal Reserve is currently undergoing an examination of Regulation Z, which implements the Truth in Lending Act, and student loans fall under the Truth in Lending Act. What regulation do you think is necessary over and above what is provided in the Truth in Lending Act now?

Mr. CUOMO. I think you could provide clarity or direction on how those current regulations apply to student loans: no revenue sharing, no undisclosed kickback arrangements, open competition. If the school is putting together a preferred lender list and you know the students are in a position of reliance on that list, then the essence of the word "preferred" means preferred by the students, not preferred by the school. That is what "preferred" means in that context, that the preferred list should be in the best interest of the students, not in the best interest of the school.

I do not really believe it is a question of new laws or new jurisdiction. If you wanted to clarify how those regulations pertain to this area, I think that would be appropriate.

Senator ALLARD. Do you believe that this can be accomplished under the Fed's existing authority?

Mr. CUOMO. Yes, sir.

Senator ALLARD. Or do you think there is a need for new legislation now?

Mr. CUOMO. Well, I think because of the inaction, there is a need for legislation, direction. Thinking back to my days as HUD Secretary, there were a number of ways the Senate could communicate its desire to me. It happened in this room many times. Sometimes I got a law passed. Sometimes I got a letter. Sometimes I got a phone call. But I think the—I do not think it was a question of additional jurisdiction. Legislation that would clarify and specifically apply the current Federal jurisdiction to student loans either through the Truth in Lending Act or through the deceptive practice FTC jurisdiction.

Senator ALLARD. Now, students spend a good deal of time searching out a university or college that they want to go to. Is there anything that we need to do that would give them more information when they are seeking out a loan other than the disclosure part from the university when they put them on the preferred list? Anything beyond—it seems that most of your testimony is just directed to the school and having them—what happens when they get it on a preferred list? Is there anything over and above that other than what is required by Truth in Lending that we could do to help the student be a better shopper, somewhat in the manner in which they are out there shopping for the university they want to go to?

Mr. CUOMO. Senator, that is what we are working to do in my office. We are going down two tracks:

No. 1, we are trying to inform high school graduates who are planning to attend college and their parents, educating them as to the maze of options they face, because as Senator Schumer said, it is confusing. It is confusing for me to try to understand all these programs and all these options. So we are undertaking an education effort for high school graduates and their families here. Here are your options: Stafford loan, PLUS loan, private loan. We are also operating a website and an information hotline where people can call in and say here is my situation, here is my question, and they can get an objective response.

Incidentally, some schools operate an information hotline, and you could call a school, a financial aid office, think you are talking to the financial aid office, but you are actually talking to a lender who mans that call-in center for the school, and you would never know it. You wind up taking that loan because that is how the school financial aid officer suggested it. But I believe there is an education effort for high school graduates.

The second prong, stop the scams that are misleading them. At the top of that list is the "preferred lender" list, revenue sharing, undisclosed kickbacks and commissions—stopping the scams which are now affecting them. We are trying to do both.

Senator ALLARD. Is it possible a diligent student today and their parents, is it possible for them under current law to get the total cost of that loan?

Mr. CUOMO. You can put together a package of loans that can cover the total cost, if you are creditworthy, if you can—if you qualify for the loan, if you are willing to sign the loan.

Senator ALLARD. My question for comparison purpose, you know, they can go to several lenders and say, OK, here is the loan, here are the fees that we request, here is the payment schedule, and you have three or four lenders out here. Is there enough information that is generally provided for students if they are diligent to be able to make those comparisons between three and four different loans, loan providers if they would go to them and ask the total cost of that loan?

Mr. CUOMO. It is theoretically possible. I would argue it is practically impossible. Trying to determine what your interest rate would be on a private loan, you often do not get that number, the interest rate that you are going to pay, until you are virtually signing the agreement. So it is very hard to comparison shop where you can go to one website or one source and price different loans. It is extraordinarily hard, if not impossible.

Senator ALLARD. I think my time has expired here, Mr. Chairman. Thank you.

Chairman DODD. Well, thank you very much, Senator.

Senator Casey.

Senator CASEY. Mr. Chairman, thank you.

Attorney General Cuomo, thank you again for your testimony. I wanted to direct your attention to two areas: one is the Code of Conduct, and the second is the question of oversight.

I noticed in your testimony—and you had spoken to this directly in your written testimony—that the Code of Conduct that you entered into with these institutions covered, I guess, four or five, at least in terms of prohibitions: gifts, trips, the kickback issue, as well as the call centers. In other words, these schools agreed to do this, and it became, in essence, voluntary.

The question I have for you—and I am thinking of my own experience as a State official, a State elected official, where we had a code of conduct in the department that I ran, the Auditor General's Department, and we would actually have employees sign it, which kind of conveyed a sense of commitment and seriousness. In that instance, it was mandatory because I could make it mandatory.

Do you think it should be kind of a case-by-case or institution-by-institution decision that they enter into an agreement with your office or a similar office in various States? Or do you think it should be somewhat made mandatory either at the State or the Federal level?

Mr. CUOMO. Senator, I believe it should be mandatory. I think it should be a Federal directive, Federal regulation, Federal piece of legislation, whatever vehicle you would deem appropriate.

We have passed a law in the State of New York that makes it mandatory in the State of New York. So our Code of Conduct is the law of the land in the State of New York. It applies to every college, every lender doing business in the State. That is one State.

I would argue that same law, through whatever the appropriate Federal vehicle, become the Federal law of the land.

Also, Senator, we have signed up 25 schools. We have signed up seven of the largest lenders. In many ways, we are getting there anyway. It is now a function of settlements on specific actions, and that is how we have gotten to 25 schools. But we have the seven lenders; we have the top five largest lenders in the country who have already agreed.

So I believe we are getting there, and the marketplace is demanding that we get there. Students are demanding that we are getting there. We have been trying to inform students that when you go to the school, ask your school, "Have you signed on to the Code of Conduct? And if not, why not?" When you go to shop a loan, ask the lender, "Have you agreed to the Code of Conduct? If not, why not?"

But you can make this the law of the land. You could take this reform that the marketplace is already accepting. If this was impossible, Senator, we would have known about it by now. If it was impossible, the largest lenders in the United States would not have signed on to the code. Some of the largest schools in the country would not have signed on to the code. They are telling you they can do it. Since they can do it, with the appropriate Federal action it will become the law of the land. It hurts no one. The lenders will still do business. I argue that it is going to be better for the lender's business. The students will be protected; the schools will be protected.

Senator CASEY. It became the law in New York when?

Mr. CUOMO. Several weeks back.

Senator CASEY. OK, just this year. Have any other States done anything similar to this in terms of passing this law?

Mr. CUOMO. No.

Senator CASEY. OK.

Mr. CUOMO. New York State passed the law. Many of these investigations have come out of New York, have been pushed by my office. We drafted a piece of legislation which just takes the Code of Conduct that the lenders are signing and schools are signing, takes that Code of Conduct, made it a piece of State legislation. That State legislation I think is very similar to the sunshine proposal, sunshine law proposal in the Congress, which would take a lot of the same concepts of the Code of Conduct and make it Federal law.

Senator CASEY. My second question—and maybe more than one, but under the heading of oversight, you said a couple of times—and I wanted to make sure I got this right—that all the actions you took as the Attorney General of New York could have been taken or similar actions could have been taken by FTC, OCC, and FDIC, those three at least?

Mr. CUOMO. Yes. And, Senator, as you heard, before your time here I was in this seat as HUD Secretary. I believe in the Federal Government, and I believe in the authority and the ability of the Federal Government. I am now a State official. I really believe this is better handled by the Federal Government. This should not be up to a State Attorney General. This should not be one State's law where, if you happen to be a New York student, you are going to

have this level of protection, but if you are Connecticut student, you do not, or if you are a Pennsylvania student, you do not.

I believe this is the place where the Federal Government can and should act, and I believe they already had the jurisdiction. They chose not to exercise it. Omission or commission. But I do not believe there is a single action I brought that the Federal regulators could not have brought if they were attentive.

Senator CASEY. And in light of your experience, you know what being called before a Committee can do. You prepare for it. You are cognizant of what the oversight means to you, and I think that stands to reason.

I will not ask you to comment on this. You can if you want, but I think one thing we should consider is bringing some of these agencies in front of this Committee to ask them why they were not taking such actions, and I think that is something the Committee should consider. And, of course, when and if that happens, we would ask you to help us prepare the questions.

Mr. CUOMO. It would be my pleasure, Senator.

Senator CASEY. Thank you.

Mr. CUOMO. The world turns, Mr. Chairman.

Chairman DODD. I was going to say, the idea of a former Cabinet Secretary preparing questions for other Cabinet people——

Mr. CUOMO. Oh, I know the tough ones, Mr. Chairman.

[Laughter.]

Chairman DODD. Ones we never asked you when you were in that chair.

Senator SHELBY. I think he was asked a few.

Chairman DODD. Senator Reed.

Senator REED. Thank you, Mr. Chairman, and I want to commend you, Attorney General, for your very visionary and aggressive efforts in this regard. You have saved lots of families a lot of money that is desperately needed for college education, so thank you for that.

Mr. CUOMO. Thank you, Senator.

Senator REED. Do you think that the authority exists today to clearly delineate and label so that there is no confusion a Federal loan versus a private loan? And should that be done? Is that a first step?

Mr. CUOMO. First, Senator, it is a pleasure to be before you once again.

I believe the distinction between the two loans is clear. I think what practices are allowed under each is unclear. The revenue sharing we are talking about, that is not a question of a lack of clarity. Revenue sharing is illegal under the Federal loan program. I believe it is illegal under the private loan program, but that is a possible area of lack of clarity.

Senator REED. So that it would be helpful, either through regulatory guidance or through legislation, to clarify that the revenue sharing is not permissible in the private loan field? Is that your view?

Mr. CUOMO. Yes. The Department of Education proposed new regulations last week that would only apply to the Federal loan side. They say they have no jurisdiction on the private loan side. But all the wrongs that they are trying to right—which I would

argue too little, too late, but they now have at least proposed regulations—that does not apply to the private loan side.

Senator REED. And I understand that our colleague, Senator Kennedy, is working on legislation that will closely parallel the Code of Conduct, and Senator Dodd and I and others on the Committee will be involved, we think next week, in the Higher Education Act reauthorization, the beginning of the markup. And I would assume that you would encourage us to include those provisions in any bill with respect to higher education.

Mr. CUOMO. Yes, Senator.

Senator REED. Well, thank you. Again, Attorney General, thank you. You have really gotten off to a very aggressive and very productive few months in office. Thank you.

Mr. CUOMO. Senator, I told the Chairman before I came in, I said it is because you taught me well when I was down here, Senator. The 8 years I had in the Federal service, sometimes being Attorney General seems easy compared to what I went through in Washington.

[Laughter.]

Chairman DODD. Well, Mr. Attorney General, we thank you very much—I am sorry. I did not see you. Senator Crapo, I apologize. I did not see you walk in.

Senator CRAPO. Thank you very much, Mr. Chairman, and, Mr. Attorney General, I appreciate having you with us. I am sorry I was not here for all of your testimony, but I have reviewed it, and one question that I had is: As you have indicated in your testimony, we have found that some lenders have been able to get on the preferred lender list by paying schools to put them on the list or somehow providing an incentive to the school to get on the list so that they are presented to the students. Do you have any data to indicate whether those institutions at that point are able to adjust the interest rates that they utilize for their loans because they have made it on to the preferred list?

Mr. CUOMO. I am sorry, Senator. I may——

Senator CRAPO. In other words, are they able to raise, to increase the rates of interest that they would otherwise charge for their loans by having made it on to the list?

Mr. CUOMO. Once they get on the list, do they raise their rate?

Senator CRAPO. Yes.

Mr. CUOMO. I am sorry. I am not following the question.

Senator CRAPO. Well, as I understand it——

Mr. CUOMO. Or are the ones with the lowest rates getting on the list?

Senator CRAPO. No, it is the former. The question I have is: Is there an ability by an institution that is able to successfully get on the list to then charge a higher interest rate than it had previously been charging for its loans?

Mr. CUOMO. Well, Senator, it is not that you get on the list necessarily because you have the lowest interest rate.

Senator CRAPO. Right.

Mr. CUOMO. This is not like an open competition or a bidding process. Thinking about it today, it reminds me that I had conversations with the Committee about their problems with sole-

source contracting, and their point was you should have an open competition, get the lowest rate for the taxpayer.

These are akin to sole-source contracts. You wind up on the preferred lender list because you had a relationship, because you went to the right conference, because you were offering revenue sharing to the school, because the financial aid officer has stock in your company. It is not that you wind up on the list because you won the place on the list necessarily because you offered the lowest rate.

That is one of the problems with these lists. They are not encouraging open competition which would drive the interest rates down and get the best deals for students. To the extent there is competition, it is on perks, it is on what I call kickbacks to the schools, it is on personal relationships with financial aid officers, but it is not about offering the best interest rates to students as a rule.

Senator CRAPO. Now, it is my understanding that you are not proposing that we get rid of the list. You are saying that the system by which an institution gets on a list should be more competitive and, therefore, drive the rates down in the lists that are presented to the students.

Mr. CUOMO. Yes. I believe the school can serve the purpose that Senator Allard was referring to, who is going to decipher this maze of options and this multitude of lenders. The school could say, "We undertake that service. We are going to do the due diligence. We are going to do the research, and then we are going to recommend to our student population these are the three best lenders, in our opinion, for our school." That could be a great service. It could be a great service—if they undertook that responsibility and if they did it in the best interest of the student.

My problem is they are saying these are the preferred lenders. It is often not because of due diligence, because they were thinking about the student, because they had a competition and brought down the rates. It is preferred by the school in actuality, not preferred by the student, and that is deceptive, in my opinion.

Senator CRAPO. And do you have a suggestion or an idea as to how we could cause that to happen? Obviously, we could pass a law or something. Do you think legislation is needed, or do you think that some other kind of incentives are needed to cause schools to do what you just described?

Mr. CUOMO. That you would need to do by a regulation or clarification or advocacy of one of the agencies to propose a regulation that does it or legislation, if nothing else is effective, if not always fast.

Senator CRAPO. Do you have any suggestions as to what students or families of students could do to obtain the best possible loans for college, private loans?

Mr. CUOMO. We also chatted about this with Senator Allard before you came in. The education process that a family or an individual has to go through here to be an informed consumer is burdensome and tedious because this is a very, very complicated transaction. That is why 90 percent of the students tend to be taking a preferred lender by the school, because they look at the landscape and they say, "This is complicated. It is hard for me to figure out. I will trust my school. I believe in the school. That is why I tried

to get in. That is why I am paying all this money, so I will trust the school." Ninety percent follow the recommendation of the school.

So I think that could be a good vetting vehicle, but then that vehicle actually has to operate in the best interest of the student, which they are not doing. As a matter of fact, they are, I believe, taking an undisclosed commission at the expense of that student.

Senator CRAPO. All right. Thank you very much.

Thank you, Mr. Chairman.

Chairman DODD. Thank you very much, Senator.

Mr. Attorney General, we thank you once again for joining us here. You have made some very good recommendations, and Senator Shelby and I will be talking with our colleagues here about the best way to proceed on this. And Senator Casey suggested—and I think it is an idea we will take into consideration—the idea of having actually some of the regulators come in to talk about what they believe they have the authority to do or not to do in this regard, and to examine whether or not some action could be taken. We have the Higher Education bill moving along in the other Committee, and my hope would be that if there is action to be taken by this Committee, we would try to think of doing so at least in conjunction with that action at some point either on the floor or whatever. But we need to examine this thoroughly and carefully to determine whether or not new authority is necessary or just getting the institutions to exercise existing authority. And I would be very interested to hear what my colleagues have to say about that at the appropriate time.

Senator SHELBY. Senator Dodd, I just want to make an observation. The laws ought to be uniform if it is a Government loan or if it is a private loan. We cannot have one standard for one and another standard for the other. I think the Attorney General pointed that out, alluded to it several times.

Mr. CUOMO. And, Senator, if I might, the Department of Education just put forth a regulation, which is not perfect but it could be improved, that applies to the Federal loans. If that same regulation was just applied to the private loans, you would have done these students and families a great service.

Senator SHELBY. Yes. Thank you.

Chairman DODD. That is what we want to look at here. Certainly, my intention would be to insist that happen. The question is: Can you do it under existing regulations and statutes, or does this Committee and the Congress need to act to give these agencies additional authority which they may claim they do not have? If that is the case, then I would aggressively pursue taking such action. If they can do it without it, then my intention would be to pursue them aggressively to see that they exercise the authority they have. But I think all of us here—I would hope all of us here agree that this is a very, very important area of interest. This is a critical component of the economic success of this country. If you leave the American student behind for a decade, you are going to leave this country behind for a century, in my view, when it comes to competitiveness in a global marketplace today. This is a very, very critical issue not just from an economic standpoint and fairness standpoint. Someone mentioned last year the number—and I

do not know if this is an active number—that somewhere between 200,000 and 250,000 students who graduated from high school were accepted to a higher institution of learning and did not go because of cost.

If we are losing close to a quarter of a million kids who are not going on because they cannot afford to go on, that is a frightening statistic to me, not to mention the half million to a million students who drop out of school every year. These numbers are startling and very troublesome in terms of our ability as a Nation to continue to compete effectively in a very competitive global marketplace, and the ability for students to get on and get that higher education is very important to them and their families. It is also important, very important, to us as a country.

Mr. CUOMO. Yes.

Chairman DODD. And so beyond just what happens to students and their families, as bad as that is, our country will pay an awful price indeed if we are pricing education out of the market for an awful lot of families in this country, and students. That really does great damage to our Nation.

So we want to move quickly on this, and we will, to try and close this gap. But thank you again immensely for your leadership.

Mr. CUOMO. Well stated. My pleasure, Mr. Chairman. Thank you.

Chairman DODD. Thank you very much.

We will go now to our second panel here, and I thank them for their patience. I am going to call you up and ask you to take the witness stand, if you will, and we will move along as quickly as we can. I will get back to my list of witnesses here

[Pause.]

Chairman DODD. Well, again, you have already joined us here. Well, thank you very much. You are all very quick here getting up to the chairs.

Jonathan Avidan works in Newtown, Pennsylvania, for Calle Financial Network, an investment advisory business, is Director of Operations. He is a registered representative with NASD, attended Boston University School of Management with a B.A. in Science in 2004.

Luke Swarthout works as a higher education associate with U.S. PIRG on higher education access and affordability issues. He is the author of several reports on student debt and financial aid, including "Paying Back, Not Giving Back: Students' Debt Negative Impact on Public Service Career Opportunities."

Jennifer Pae is the elected president of the United States Student Association, the country's oldest and largest national student association, representing millions of students nationwide. Ms. Pae oversees the national campaign for the organization and recently ended her term as the primary student negotiator for the Department of Education's Negotiated Rulemaking Student Loan Committee. Thank you, Ms. Pae, for being with us.

Sevester Bell is the Director of Student Financial Aid at Howard University. Mr. Bell began his career in banking and finance as assistant manager of Household Finance Corporation after serving 4 years in the United States Marine Corps. He began his Howard University career in 1979 as the Assistant Director of the Univer-

sity's Office of the Bursar and has served in various roles in student aid administration until January of 2005, when he was appointed Director of Student Financial Services, and we thank you very much, Mr. Bell.

Peter Tarr joined First Marblehead as general counsel in 2005, elected Chairman of the Board of Directors in October of 2005. From 1986 to 2005 he was the senior partner in the Corporate Law Department and member of the Executive Committee of the law firm of Wilmer, Cutler, Pickering, Hale & Dorr. He received his B.A. from Yale, M.A. from Yale Divinity School, and J.D. from the University of Virginia, and we thank you very much for being with us.

Tracy Grooms is the Senior Vice President of Student Lending at Bank of America. Ms. Grooms joined Student Lending in March of 2006 and leads aspects of the business, including credit loan organization and student call center capability. Tracy Grooms joined the Bank of America in 1983 as a financial analyst and has held a variety of positions in the finance group, including planning and financial reporting. A graduate of the University of South Carolina, Tracy has a degree in accounting and holds an MBA from the McColl School at Queens University in Charlotte.

And, last, Barry Goulding has been a Senior Vice President and Sales Manager at SLM Corporation since May of 2001, where he manages the company's internal lending brands, education loan product management, including private credit loans, online school solutions, and sales reporting. From 1994 to 1999, Mr. Goulding served as Vice President of Education Loan Product Management. He was promoted to Assistant Vice President in 1984. He has his B.S. degree from Carnegie Mellon University.

We thank all of you. A rather long list here, and I apologize for packing you in this tightly along the way. I am going to ask each of you to keep your remarks to 5 minutes, if you would, and then we will submit your full testimony as part of the record and any supporting documents you think are worthwhile.

Let us begin in the order that I introduced you.

**STATEMENT OF JONATHAN AVIDAN, CONSUMER**

Mr. AVIDAN. Chairman Dodd, Ranking Member Shelby, thank you for the opportunity to appear here today to discuss private student loan lenders.

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

My parents, like the majority of middle-class Americans, struggled with the enormous challenge of spiraling college costs during my first 2 years at Boston University. Prior to my junior year, they told me they could not afford to pay my tuition anymore. I was faced with a grim choice: go home and enroll in my local community college, or stay at Boston University. I wish I knew at the time that the choice to stay would be the most expensive decision of my life.

I was able to borrow $18,000 of Government loans at a fixed 3 percent, but this only covered a fraction of school costs. I would be forced to find the vast majority of funds through private loans—over $60,000 for the remaining 2 years. I have been making payments every month for the past 2 years, but the balance has managed to increase to $69,000.

I was told up front that the original 6.36 percent variable interest rate was capped at 10 percent and that it was tied to the prime rate. How many 20-year-olds really know what that means? The truth was the variable rate was not capped. In fact, the rate was the current LIBOR rate plus a margin of 4.85 percent. The 4.85 percent was derived, at the time, from my parent's credit score and our combined creditworthiness. I cannot believe that the original terms of the promissory notes could not be reevaluated after 5 years. Then I was 20 years old and I had no credit history or income. Now I am 25, with a flawless credit history and a credit score of over 720 points. I deserve a better margin now than I did 5 years ago. Currently the rate is 9.92 percent.

Right now, despite generous and timely raises and my wife's income, we are hard pressed to keep up with the combination of rate increases and graduated payments. My private student loan payments, $250 when I first graduated, have gone up over 200 percent in the last 24 months. Currently, I am paying $600 a month. By April 2009, my payment will be approximately $1000 a month. I will not begin to reduce the principal for another 2 years, and my expected payoff date is November 2024. When it is all over and I have paid off all my debt to these lenders, I will have paid back close to triple the amount that I borrowed.

As a new borrower, I purchased a used car for $18,000 at 10.1 percent interest over 6 years. I find it rather remarkable that the rates on my private loans would come so close to the percentage rate on my used car. Surely, I am a better risk than a 4-year-old sedan.

Ultimately, my life is completely affected by my private student loans. Instead of renting a one-bedroom apartment, my wife and I could be taking a mortgage on a house. Instead of decades of interest, I could be contributing to an IRA or putting money away in a 529 Plan for my children. Instead of being forced to work right out of school so I could afford to pay my private loans, I could have pursued a graduate degree at Wharton, a lifelong dream of mine.

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

Young men and women graduating from colleges around the Nation are supposed to strengthen the economy once they enter the workforce. But how are we supposed to help the economy when we are struggling to help ourselves? I know that I am only one voice and one story, but I am sure all of you know that it is young people

like myself that are the future of this country and it is only getting worse.

So, again, I would like to thank both of you for having me here. Thank you.

Chairman DODD. Thank you very much.

Ms. Pae.

**STATEMENT OF JENNIFER PAE, PRESIDENT, UNITED STATES STUDENT ASSOCIATION**

Ms. PAE. Thank you, Mr. Chairman and Senator Shelby, for allowing me to be here today.

As stated earlier, private student loans are the fastest-growing and most profitable part of the student loan industry. Ten years ago, only 5 percent of total education loan volume was in private loans. Today they represent 20 percent of what all students and their families borrow to pay for school. With the rising cost of tuition and fees and the lack of sufficient Federal and State grant aid for low- to middle-income students and families, the private loan industry has grown exponentially off the backs of those who are the most vulnerable.

Private loans have higher interest rates, fewer borrower benefits, and often saddle students with larger debt levels than Federal loans. Nearly two-thirds of the 15 million college students graduate in debt that averages nearly $20,000. This number is only expected to increase without Congress taking action to protect student borrowers from unmanageable levels of debt.

Students are continually inundated with solicitations from lenders through direct mail, the Internet, and savvy advertising campaigns promising to guarantee up to $50,000 in just seconds. From letters that are made to look like official documents from the Federal Government or the Department of Education to co-branded loans with colleges and universities, most borrowers cannot distinguish differences between loans that are helpful and those that are harmful.

Not only are students faced with skyrocketing tuition and fees, but they are graduating with high levels of debt that force them to put off starting a family, buying a home, pursuing careers in public service, and even furthering their education. Paul Perry graduated last month with a degree in political science and international studies from American University and also with a bill for over $75,000—$45,000 of which are private loans. Paul will be giving back to a community in need through Teach for America this fall and unfortunately, like millions of other borrowers, has no idea how he will repay such massive debt. Regardless of economic backgrounds, from low-income working class families to middle-income families, students are being forced to rely on private loans to fill the gap between available Federal aid and the cost of attending college.

For all of these families, especially first-generation college students like myself, a college degree is the best shot at future economic security and achieving the American dream. Yet college is quickly becoming out of reach for millions of students. Instead of America stepping up to the challenge to vie in a highly competitive global economy, we are retreating by failing to invest in higher

education and providing adequate protections from the private student loan industry. Every qualified student should be able to access higher education regardless of their economic status. With student loan debt spiraling out of control and the compromised integrity of both the Federal and private student loan industry, the need for congressional action is more apparent than ever before.

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

This case highlights an alarming industry practice of tricking borrowers into higher-cost private loans before exhausting their safer and lower-cost Federal student aid options.

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

The focus should really be to reduce the need to rely on private loans, ensure that private loan borrowing that does occur is affordable, and mandate that clear and accurate information is presented to student borrowers to allow them to make responsible educational financing decisions. We also urge Congress to adopt legislative solutions proposed by The Project on Student Debt. These solutions include: treat private student loans like other consumer debt in bankruptcy so there is a safety net for vulnerable borrowers buried in private student loan debt; clearly label private student loans as different from Federal loans so students understand their options before making crucial financial decisions; make it easier to compare private student loans and require private lenders to disclose in plain English the rates, terms, and conditions of private loans when the student or parent receives approval; and to protect borrowers who are harmed by conflicts of interest or fraud so that students are not caught in a cycle of debt due to deceptive practices by lenders or schools.

In conclusion, we urge Congress to pass legislation that regulates the growing private loan industry in order to protect the rights of current and future borrowers. The door of higher education is closing for millions of Americans under the weight of high-cost private loans due to inadequate Federal financial aid. Economic insecurity is replacing economic opportunity for hard-working college graduates who are confronting spiraling debt. By enacting reforms in the private student loan industry, we are taking a step toward opening these doors of opportunity.

Thank you again, and we look forward to working with you to be able to address these problems.

Chairman DODD. Thank you very much, Ms. Pae.

Mr. Tarr.

**STATEMENT OF PETER B. TARR, GENERAL COUNSEL, FIRST MARBLEHEAD CORPORATION**

Mr. TARR. On behalf of First Marblehead, I thank Chairman Dodd, Ranking Member Shelby, and the Committee for inviting us here to discuss this very important issue.

First Marblehead provides outsourcing services for private, nongovernmental education lending in the United States. Founded in 1991, First Marblehead today employs more than 1,000 people working primarily in the Boston area.

First Marblehead helps meet the growing demand for private education loans by providing financial institutions with an integrated suite of private loan services—from program design——

Chairman DODD. Come a little closer to the microphone.

Mr. TARR. I am sorry. From program design through application processing. Over the past 16 years, we have helped our lender clients deliver more than 1 million loans, and in the process we have assisted more than 600,000 students in the pursuit of their educational goals.

As we have heard this morning, the annual funding gap between the cost of education and traditional funding sources such as Federal student loans, scholarships, and grants continues to widen, and today we estimate that gap at traditional 2- and 4-year public and private institutions to be $122 billion.

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

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

Because they are not federally guaranteed, the risk of default on private education loans is borne by the lender or loan holder. This most fundamental difference is a key limiting factor as to who might actually qualify for a private student loan. Private loan borrowers must typically qualify for the loan by meeting certain credit criteria. Not all applicants for private loans are approved for the loans. Approximately one-half of the applicants for First Marblehead-facilitated private loans are declined due to insufficient credit. In fact, few if any undergraduates can meet our strict underwriting criteria on their own, so they enlist their parents or another experienced borrower to co-sign the loan. As a result, the "typical" private loan borrower in the programs we administer is an undergraduate student with a 50-year-old parental co-signer with an average

FICO score in excess of 700. Approximately 80 percent of the loans we process are co-signed. The remainder are generally to older students or non-traditional students—who have the requisite credit history.

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

Private education loans are offered by providers through two distinct channels. Historically, most private loans have been originated via the school financial aid office, similar to how Stafford loans are administered. An increasing percentage of private loans are originated directly between the borrower—typically a student and an adult cosigner—and the loan provider. The growing range of product types, features, and providers allows borrowers to choose private loan products and providers based upon their own personal preferences and selection criteria.

Postsecondary education is a large and highly impactful investment for students and families. With the cost of college continuing to rise at a rate far exceeding inflation, it is critical that students make sound financial decisions in determining how to pay for college. No one benefits—not the student, the school, the lender, nor First Marblehead—when a borrower struggles to repay their private education loan. To foster smart borrowing, First Marblehead initiated a borrower information program in mid-2006 to encourage students and families to carefully consider the full range of opportunities available to them.

Our industry is heavily regulated, and I have listed in my prepared remarks the agencies that we are subject to. We are also governed by Truth in Lending, Equal Opportunity Employment, and Title IV Gramm-Leach-Bliley.

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

Thank you.

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

Ms. Grooms.

**STATEMENT OF TRACY GROOMS, SENIOR VICE PRESIDENT, BANK OF AMERICA**

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

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

The bank is optimistic about growth prospects in the student lending industry, and private lending in particular. The number of people choosing higher education continues to grow. The cost of higher education also continues to grow, and the availability of grants and lower-cost direct Government or FFELP loans has not kept pace.

Consider, for example, that the average annual cost to attend a 4-year public college is almost $13,000, while the maximum amount per year of a Government-backed loan is only $5,500. As a result, Americans are filling this gap with private education loans. Such trends have led Members of this Committee to express concern about rising levels of student debt.

We believe individual students' debt levels should be manageable for two reasons. First, the bank's overall business objective is to serve customers throughout the major financial events in their lives—buying that first home, saving for retirement, and, yes, saving and providing for children's education. Second, industry participants are vigilant in managing credit losses resulting from student loans, as defaults impact the overall customer experience and margins. Accordingly, we seek to ensure consumers receive loans in amounts and with terms they can afford.

The private education loan market has produced affordable products with flexible terms. Today, for example, students can get unsecured private education loans that: defer all payments until the student is out of school and has an opportunity to obtain employment; may be repaid over periods as long as 25 years; and include fair interest rates.

As part of our marketing, we make students and their parents aware of all available options for education financing, including grants, lower-interest Government-backed loans, and private education loans.

In sum, the private education loan market serves an important consumer need, with Bank of America and lenders competing to provide affordable products in appropriate amounts.

In the remaining time I have, I would like to address briefly sales practices. At Bank of America, one of our core values is "Doing the right thing." Consistent with that value, we have several longstanding policies that prohibit associates from making improper payments of any kind to schools, guarantors, or customers. As a result, Bank of America has not provided lavish trips or gifts to financial aid officers; Bank of America has not used "advisory

boards" of school representatives; Bank of America has not given stock to financial aid officers; and Bank of America has not provided staff to operate call centers on behalf of schools or provided computer hardware or software to schools.

Finally, we voluntarily chose to adopt the New York Attorney General's Student Loan Code of Conduct as a way of leading by example, encouraging others in the industry to follow. We will continue to operate our business according to the highest business and ethical standards. We are proud to be part of the student lending industry. At a time of rising education costs, diminishing grants, and federally backed financing, private education loans remain a good alternative for students and their families.

Thank you for your time, and I am pleased to answer any questions.

Chairman DODD. Thank you, Ms. Grooms.

Mr. Goulding.

**STATEMENT OF BARRY W. GOULDING, SENIOR VICE PRESIDENT, SALLIE MAE**

Mr. GOULDING. Chairman Dodd, Ranking Member Shelby, on behalf of Sallie Mae's 12,000 employees, thank you for giving us the opportunity to describe how we are helping millions of students and families pay for one of the most significant investments of a lifetime—a college education.

We all know that the dramatic rise in college cost has outpaced the growth in Federal grants, Federal loans, family savings, and family incomes. Students and families face an increasing gap between the price tag for college and available resources. As a result, many families have been forced to seek out other ways to finance college, including private education loans. As has been discussed this morning, private education loans are regulated, yet we understand that the growth in the private education loan market raises important consumer and policy questions.

Consumers, schools, lenders, and policymakers all share a common interest in making sure that students have access to college, complete their academic programs, and successfully transition to the workplace. In an effort to do our part, Sallie Mae advises students to minimize their total borrowing by tapping into whatever existing resources they have, whether it is personal savings or a 529 plan. Our Upromise subsidiary manages over $17 billion in 529 college savings plans and assists more than 7.5 million members.

We counsel students on the 1–2–3 Approach to paying for college. One, after exhausting personal financial resources, a student should tap into free money, such as scholarships and grants. Two, if borrowing is necessary after tapping into free money, students should take advantage of low-cost Federal loans. Three, and only as a last resort, to enable access to college students, students should turn to private education loans or other consumer lending alternatives.

Additionally, students should understand how their loans work before they undertake any debt. We provide information to students about the rates and terms on their loans before, during, and after they are in college. And when it comes time to pay back loans,

borrowers must have access to programs to help them manage their debt.

The financing gap, driven by rising college costs, is what has driven the growth in private education loans. To put this in perspective, in academic year 2005–06, Sallie Mae originated approximately $22 billion in Federal and private loans, including $7 billion in private education loans. In fact, even though Howard University is a direct lending school, Howard borrowers utilized over $10 million of Signature Student loans, which are Sallie Mae's private education loans, to help them close that gap. We designed our private education loan programs to mirror Federal student loan programs in many respects.

Since many students have little or no income while they are in school, we do not require our borrowers to pass an income or a debt-to-income test. Like Federal student loans, private student loan borrowers can delay making any payments until 6 months after they complete their studies. While we have been successful in mirroring many of the characteristics of the Guaranteed Student Loan Program, we cannot mirror Federal rates and fees. Without Federal insurance, lenders appropriately price private education loans using a risk-based model.

The bottom line is that lenders take 100 percent of the repayment risk on loans made to people with no income, limited credit histories, and to people who will not begin to even repay their loans for several years. At Sallie Mae, we believe that private education loans are an investment in human capital. Fortunately, the overwhelming majority of our customers are successfully managing their private education loan debt, and the median interest rate across our entire $25 billion in private education loans is prime plus 2.

As the demand for these products has grown in recent years, we have introduced several new enhancements. We expanded our disclosures to strongly encourage potential borrowers to max out on their Federal student loans before taking out any private loans. We believe that the 1–2–3 Approach that I mentioned is working. At Sallie Mae, 85 percent of our customers only have FFELP loans, and I did bring a sample of some of these disclosures that I would request be included in the record.

We created additional safeguards to prevent borrowers from inadvertently borrowing more than the cost of attendance. We reduced our maximum private loan interest spread and fees. We introduced a private loan consolidation program to help borrowers lower their monthly payments, and over 75 percent of those who have used this program to date have not only lowered their monthly payments, they have also lowered their interest rates.

We have launched an online education program to provide counseling tools to help borrowers understand debt before they ever take out a loan and to manage their debt and to protect their credit score.

In summary, Mr. Chairman, access to private education loans is increasingly important and can make the difference as to whether or not a student goes to college. At Sallie Mae, we will continue to make constructive enhancements, and we look forward to working with Congress on this important issue.

Chairman DODD. Thank you very much.

Mr. Bell, thank you for being here.

**STATEMENT OF SEVESTER BELL, DIRECTOR OF STUDENT FINANCIAL AID, HOWARD UNIVERSITY**

Mr. BELL. Chairman Dodd, Ranking Member Shelby, on behalf of Howard University, I would like to thank you for the invitation to testify during this most important hearing on the student loan industry.

As a participant in the U.S. Department of Education's William D. Ford Direct Lending Program, Howard University does not accept Federal Stafford loans processed by private lenders. Since the university moved to direct lending in 1997, it has eliminated the need for Howard students' utilization of private lenders as it relates to servicing Federal student loans.

As a result, the university's cohort default rate was reduced from a high of 11.7 to its fiscal year 2005 draft cohort default rate of 3.2 percent. For fiscal year 2006, Howard University students and parents borrowed nearly $110 million in Federal direct Stafford and PLUS loans, and almost $18 million in non-Federal Stafford loans from private lenders. Private loans constituted only 13.8 percent of all student loans at Howard University in fiscal year 2006.

Howard University remains steadfast in ensuring full compliance with Federal student aid regulations. In response to New York State Attorney General Andrew Cuomo's initial inquiries into the private lending industry and its relationships with other institutions, Howard University immediately clarified its existing policy on private lenders. The university's policy on private lenders includes the prohibition of a preferred lender list and restricts financial aid officer contact with private lenders to only that which is necessary to facilitate student loan certifications.

Financial aid officers are restricted from sitting on private lender boards and committees, receiving gifts from private lenders, and must disclose any financial interest in private lenders or guaranty agencies. In addition, all financial aid staff members have signed statements on file attesting to their full compliance with university's policy.

Previously, comparative charts detailing private lending interest rates and loan criteria were provided only upon request to students. Howard University does not provide nor recommend private student loans to those students eligible to receive Federal student loans. However, upon inquiry, students who may not be eligible for Federal student loans are instructed to conduct their own search of private student loans which should include comparing loan interest rates, repayment terms, deferment and forbearance options, and other loan criteria.

The growth and development of the private educational loan industry has increased over the past 4 consecutive years despite efforts to decrease our students' overall indebtedness. Howard University has continued to experience significant growth in the volume of alternative loans processed, from $8 million in 2003 to nearly $18 million in 2006.

The popularity in and need for alternative loans are centered on four principal reasons. First, students who have reached their full

eligibility for Federal student loans must borrow through an alternative lender to secure funding each year. Second, students who have lost their Federal aid eligibility due to Satisfactory Academic Progress requirements may borrow funds through select alternative lenders who do not consider academic progress as a criterion for determining eligibility. The third reason relates to students enrolled in select graduate and professional programs, such as medicine, dentistry, and pharmacy, where students require additional funds to offset their direct and indirect expenses, as their cost-of-attendance exceeds the maximum annual loan limits offered through the Federal programs. Last, doctoral candidates in the final stages of their dissertation may be enrolled less than half-time; they also would not be eligible considering their half-time status.

In conclusion, Howard University continues to encourage its students to first utilize and exhaust all Federal loan sources prior to seeking alternative loans. Nevertheless, in many cases this advice does not deter them from entering contractual agreements within the private loan industry as they present a viable, if not the only, resource for students to fund their education.

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

Mr. Swarthout.

**STATEMENT OF LUKE SWARTHOUT, HIGHER EDUCATION ADVOCATE, UNITED STATES PUBLIC INTEREST RESEARCH GROUP**

Mr. SWARTHOUT. Chairman Dodd, Ranking Member Shelby, thank you very much for convening the hearing. My name is Luke Swarthout. I am the Higher Education Advocate for the U.S. Public Interest Research Group. We are a national network of nonpartisan, nonprofit organizations in 30 States and working on 100 campuses. I would like to just briefly summarize my written statement, and you can mix it into my written testimony below.

I think what we have seen over the last couple of years is that private student loan borrowing has expanded well beyond current regulations. In the wake of the student loan scandals detailed by Attorney General Cuomo, the subprime mortgage crisis, and certainly just families concerned about college affordability, it is clear that Congress needs to act.

Now, Congress has long treated students loans differently than other types of debt because they are more socially valuable. When a borrower invests in their education, they are making an investment not only in their own well-being but also in the social, economic, and political health of our country. Your decision to pursue the private loan industry and what oversight this Committee has jurisdiction on is well within the 50-year track record of this Congress in helping students finance their education.

Now, private loans are utilized by a subset of student borrowers. It has not been said here today, but about 5 percent of undergraduates borrow a student loan. Because these loans tend to be larger, they comprised about 20 percent of the overall loan volume last year. Interest rates on these loans are determined by the credit of the student or their parent. They can range from prime to prime plus 12, which is 8 percent at current market rates, anywhere up to 12 percent.

Now, there are a couple of reasons to be really concerned about the growth in the private loan industry, and one of them was actually identified by Chairman Dodd in his opening statement, which is that students are already facing a serious debt burden paying for college and taking out student loans, and private loans and increased reliance on private loans works counter to the very financial aid system that this Congress has built up.

We try and target the greatest aid to the students with greatest need in our loan programs and in our aid programs. But turning students over to the private loan market actually does the exact opposite. It asks students with the least, who have the greatest need, to pay the highest interest rates and to suffer the worst terms.

The second major problem and one that, Senator Shelby, you identified clearly in some of your questioning is that there is a lack of clear consumer information for borrowers out there, and I think there is a real need—and I will talk about it in some recommendations—to expand on the Truth in Lending Act. But we see a significant percentage of borrowers every year take out private loans when they have not maxed out on their Federal loans.

Now, that shows, at best, that some students are clearly misinformed, but at worst, it is the product of misleading and manipulative schemes by private lenders seeking to grow their private loan portfolios that are more profitable at the expense of students.

For a student who does manage to survey all the options and still decides to take a private loan, it is almost impossible to compare offers between lenders. Most students do not even see the rate they are going to receive until they are signing the promissory note. Lenders use other practices such as co-branding to further confuse students and shield them from the harsh reality of their loan terms.

Exacerbating this problem and worth mentioning is the 2005 bankruptcy law that treats student loans worse than almost any other type of consumer debt. This bankruptcy change, which makes it almost impossible to discharge student loans, has helped grow the student loan industry at the expense of students.

I would like to make a couple of concrete recommendations for this Committee and this Congress to take action on student loans: first, per our previous discussion, provide students with clear information about student loan terms; mandate that lenders provide students with an APR before the time that they are taking out the—before the time that they are signing the promissory note; provide students with a cooling-off period at the beginning of every semester where students can return their loans at no cost to the student, similar to what we have in Federal loan programs.

We should mandate that schools clearly distinguish between Federal loans and private loans. As mentioned earlier by Senator Reed, this is a confusion to some students. We should ban co-branding practices detailed by Attorney General Cuomo where banks use the logo and the name of the school to try and make their product seem more appealing.

We should treat borrowers more fairly in bankruptcy. Students investing in their education should be supported in that effort, and we ought to have laws that show that support. We should treat stu-

dents in bankruptcy more favorably than other consumers, not less, as we do now.

And, fourth, provide students with anti-fraud protection. We should expand the FTC holder rule to apply to all loans and all schools so that when lenders and schools engage in relationships, students can hold them accountable and have recourse.

Again, thank you so much for holding this hearing. I look forward to any questions.

Chairman DODD. Well, thank you very, very much. You have all given testimony, and I appreciate your being timely in your responses to the 5-minute rule here.

Senator Shelby and I have a recorded vote on. I think there is at least one, maybe——

Senator SHELBY. Two votes.

Chairman DODD. Two votes. So what I am going to do is we will go into recess here for a few minutes. Let us go cast our votes and then come back.

Senator SHELBY. May I make an observation?

Chairman DODD. Yes, you certainly may.

Senator SHELBY. Because I do not know if I will get back because it is noon and we have other commitments.

Mr. Chairman, this is a distinguished panel, and it is broad in scope, and I think we have learned a lot.

Ms. Grooms, I was interested in your testimony because you represent one of the largest banks in the world, probably the largest bank in the U.S. by deposits. And what you said is that your bank did not have this policy of conflicts and all of this stuff, and I commend you for that. I think that is good. I think that is a policy we have got to pursue.

Mr. Chairman, I might have some comments and questions for the record, if you would leave the record open.

Chairman DODD. We will do that, certainly, and for other Members.

Senator SHELBY. We have a lot of colleagues that are on other committees that would—and we know this is a very important subject.

Chairman DODD. I will be back, and others may come back as well after the votes, but I apologize for having you wait around a little longer to proceed. But I have some questions I want to raise with you as well and give you a chance to comment on them before we complete the hearing. So, with your forbearance, we will come back as quickly as we can. Thank you for your testimony.

The Committee will stand in recess.

[Recess.]

Chairman DODD. Well, thank you all for coming back. I want to apologize. There were two votes that went on a little longer than I anticipated. So I appreciate the patience of the panel in coming back together on this.

Let me take a few minutes. What I am going to also do, because of time constraints, we will leave the record open—I may have mentioned this before the recess here—and submit questions or allow questions to be submitted by other members of the Committee as well, beforehand.

Let me, if I can, I was going to jump to some general questions here, particularly regarding—well, first of all let me ask you, because several of you mentioned this and I would like to get a sense on the panel, particularly from the lenders here. I think you may have all said this. But if you haven't not, let me clarify for the record. And that is that you seek to ensure, I understand, that students that come through your program, that they take the free money first, the cheap money second, and then if you will, they turn to the private loan alternative.

Can I get a recognition? That is your recommendation? I see Mr. Tarr says yes. Ms. Grooms.

Ms. GROOMS. Yes.

Chairman DODD. Mr. Goulding.

Mr. GOULDING. Yes.

Chairman DODD. That is what you advise? How do you deal with this? Do you each deal with it differently in some way? What is the policy? Do you have a written policy on this?

Mr. TARR. What we do——

Chairman DODD. Watch that microphone again, Mr. Tarr. I apologize.

Mr. TARR. What we do, Senator, is in our marketing literature we include a specific paragraph advising prospective borrowers to consider all alternatives before private loans. In addition, when prospective borrowers call into our call centers, our telephone operators are advised, either through scripts or prior education, to encourage the prospective borrower to look at alternatives which would be less expensive sources of funds.

Chairman DODD. And that is part of your recommendations that go to your financial aid officers and so forth?

Mr. TARR. Yes.

Chairman DODD. How about you, Ms. Grooms?

Ms. GROOMS. Yes, Senator. I would say that it is more of a philosophy than it is a policy. And so that philosophy of informing students and parents of all of their options, to paraphrase you, of the free and cheap money first. We do that, whether it is through our call centers, through marketing materials such as the student loan guide. We also have a partnership with the Monster organization that will provide seminars within high schools and then an online tool that walks a family and a student through each sequence, each step in the sequence, to ensure that they are considering those cheaper options first and use the private loans only to fill the gap.

Chairman DODD. Is there any kind of a directive here at all? You say the philosophy. Now you have got people obviously handling these phone centers. Do they have in front of them some guidance sheets? Or is there a training period? Or is there counseling so how they handle the calls coming in so that part of that job they have initiating that conversation or beginning it they say to them words to that effect or advise them to that effect? Or is it just sort of an overall—I am not clear what you meant by the——

Ms. GROOMS. Thank you, Senator, for allowing me to clarify. When I say that it is a philosophy, I intended that to mean that it pervades every aspect of our business. So specifically to your question are our client service reps trained to ensure have you

completed your FAFSA? That is one of the questions that they will ask the family.

Are you aware of all of your sources? Have you taken advantage of those sources?

And again, we offer the marketing tools. And we also ensure on our website that we provide the student loan guide, the Making College Financial Planning Count. Again, that is the step-by-step plan that students and families can build.

And it may seem like a small detail, but on that website we even list and start with the Federal loans first, to again help ensure that the students, that is what they see first, that they are considering those options.

Chairman DODD. How about you, Mr. Goulding?

Mr. GOULDING. Yes, Senator. As I mentioned in my oral remarks, I did bring——

Chairman DODD. I heard you say that.

Mr. GOULDING. This is an example. This says the Financing College Guide, featuring Sallie Mae's 1–2–3 Approach to Paying for College. And it is laid out in detail here.

Other examples are on the website, under a tab planning for college, it has the 1–2–3 approach. But even on a website that you get to if you click to indicate you are interested in a private loan for undergraduate school, it says the Signature student loan is the most popular after Stafford loans. So even in kind of our tag line where—and Signature is our private education loan—we are emphasizing to the student that it should be taken out after they take out their Federal loan.

And if you click onto our website indicating you are interested in a——

Chairman DODD. This is Sallie Mae, for the audience.

Mr. GOULDING. This is Sallie Mae. And if you click on our website saying you are interested in a private loan for graduate school, because of the recent introduction of Grad PLUS, a student can actually borrow their entire cost of attendance through federally guaranteed student loans. We say graduate students are strongly encouraged to first exhaust Federal loan availability, including Stafford and Grad PLUS.

So it is very clear in our materials that we, in fact, are strongly advocating the 1–2–3 approach.

Chairman DODD. Mr. Bell, I am going to ask you to comment on this, as well. What advice do student loan officers give, as well, in this regard? Watch that microphone if you would, so we can hear you.

Mr. BELL. Senator, the advice that the Howard University students are provided is also to exhaust all Federal funding, to exhaust all institutional funding. However, we do not necessarily encourage the usage of private loans unless the student particularly comes to our office for advice. And then that advice is to conduct a search and compare some of the critical areas of taking out a loan such as the terms, as the forbearance and the deferment provisions, and other criteria, and then do a comparison and select your lender.

Chairman DODD. Let me ask all four of you here, in any reasonable circumstances is it ever advisable for a student to forego taking a Federal student loan in exchange of taking a private loan?

Mr. TARR. Senator, on purely financial terms, I cannot envision a situation where a private loan would be more economically advantageous than a Federal loan, given the Federal guarantee and the rates.

Chairman DODD. What do you think of that, Ms. Grooms?

Ms. GROOMS. I agree with that on financial terms. I cannot imagine that.

Chairman DODD. Mr. Goulding.

Mr. GOULDING. We have seen examples of where a parent who is not—who has some concerns about going into debt with a parent Federal loan—has actually, parents have actually made the decision that they would rather be a coborrower on a private loan that their son or daughter is the primary obligor on. And we believe that that decision is made because if a parent takes the entire debt in their name, they are concerned that it might conflict with their ability to plan for retirement and things like that. It is not what I would say is an economic decision. It is rather how is the family trying to position themselves to afford their college for their children.

Chairman DODD. Mr. Bell.

Mr. BELL. Senator, that is highly possible but, of course, we have not experienced that at the University, as a 100 percent direct lending institution. We do have a number of parents that are utilizing the Parent PLUS loan.

As I said, our—in the past year, $110 million was borrowed in direct lending and only 13.8 percent, I believe, in the private loan industry.

Chairman DODD. Let me ask you, Ms. Pae, and you, Mr. Swarthout, to respond here. What is the—you have heard the responses of the lenders here. Is this pretty much what you believe to be the case? Again, we have lenders here and they are not the only lenders in the world so I am curious to your overall reaction as to whether or not you believe that students and their families are getting advised early on that it is always preferable to take—at least except in some rare circumstance here that Mr. Goulding has identified—it is always preferable for the student and their family to take out the student loan as opposed to the private loan—or the Federal loan?

Ms. PAE. For us that would be our hope. But unfortunately the landscape currently, I think there is two points that I would like to raise up. The first thing is the type of information that is available to students. The marketplace is not fair currently for students because they are inundated with so much information. Although a lender or an institution may advise the student to go and maximize on their Federal aid if there is, for example when checking an e-mail, get $50,000 in just seconds, a student may turn to that alternative rather than applying for the FAFSA.

Another issue is if the loan package or the Federal aid package comes together with cobranded materials from the college and university. And when that information is presented to the student, a

student can very well be confused by Federal aid versus this being a private loan because my institution packaged this for me.

So although we would hope for all lenders to abide by these practices, I think unfortunately, due to the amount of information that's out there, it is very difficult for a student to be able to maneuver whether or not they are actually maximizing on their Federal aid versus I am actually taking out a private loan.

Chairman DODD. I am going to ask you to comment on this now, and I want to come back to that question in a minute and ask you about TILA and disclosure issues and lenders.

Mr. SWARTHOUT. I want to associate myself with Jen's comments, because if this is the case, and these are really the actions of all the lenders, then something is going wrong somewhere. We know that 20 percent of dependent students who take out private loans did not max out their Federal loans. We know about 50 percent of independent students who take out private loans did not max out their Federal student loans.

Chairman DODD. What is that number again, 50 percent?

Mr. SWARTHOUT. Fifty percent of independent college students do not max out, do not take the maximum Federal student loans, so not PLUS loans as Mr. Goulding was referring to a situation for parents. Fifty percent of independent students do not take at a maximum student loans, the allowable Federal student loans.

Suggesting that something is going wrong. Now whether it is co-branding, whether it is inundation of information, whether it is some lenders—and we have seen some private lenders that do not engage in the Federal loan programs and thus have a different profit motive, simply just push their private loan product without making mention or in some cases even questioning whether students should bother to fill out the FAFSA form.

So maybe it is some of those instances or a combination of the three, but there is a real problem here. I would say categorically there is no circumstance where a student should be taking out a private loan instead of their Federal student loan.

Chairman DODD. Let me ask you about disclosure because you have raised it, Ms. Pae, and it is an important point. It has been pointed out that students and parents cannot easily compare the terms and benefits of various loans or the distinctions and terms of Federal versus private loans. It gets confusing. You heard Senator Schumer talking about, in fact he was telling me privately because he has two daughters now in the midst of going through all of this, that he sat down himself to go through it, as someone who is a trained lawyer and obviously a member of these Committees. And he said it was a nightmare for him to try and understand it as a parent, trying to sort this out.

I wonder if, again the lenders here, let me ask you whether or not you believe Congress should make changes to the Truth In Lending Act disclosure requirements to provide student borrowers with enhanced information about the terms and conditions of private loans, including percentage rate information? And what other types of disclosures would any of you suggest that may be needed? And in conjunction with that, let me ask you whether or not—TILA protections do not extend to student loans in excess of $25,000. And I would be curious as to whether or not, again, the lenders here

would agree that TILA protections ought to be extended beyond that number to cover potentially all student loans? So two questions for you.

Mr. TARR. A response to your second question, Senator. We would support—we comply with TILA now and we would support any regulation changes——

Chairman DODD. Do you see any problem with doing that? Is there some reason we ought to be thinking twice about that for some reason?

Mr. TARR. Off the top of my head I cannot, because if we have procedures in place to comply with TILA now, the amount of the loan should not impact whether or not you can provide the Act disclosure.

One point I would make on the comparison shopping aspect of this: as this industry matures—and we estimate there are now about 150 providers of student loans in various states of maturity—you are starting to see, I think in response to your interest, on websites for example where you can go to websites and they will compare various loans and it is all in one place.

One observation I would make, and we have been doing this and advocating this, is this is a process that too many families start too late. This process should really be started at the end of the junior year in high school. Too frequently people are scurrying in July and August of the summer before their student is about to matriculate. And they really—and it is complicated. I cannot mislead you and tell you it is not.

But it takes a lot of work. My assessment is the information is out there. Is it all in one place, to be used as efficiently as possible? Probably not. But it is out there. I would strongly suggest that if there is any way to educate people to start this process much earlier.

Chairman DODD. What about that disclosure box we have talked about, where you get very clear on what rates are, using examples and so forth, that we have done with other financial instruments to make it clear for people as they look at it and give them much better ideas? Any objections to any of that?

Mr. TARR. No, I think a procedure and process and agreement on what would be in the box would have to be devised. But conceptually, no.

Chairman DODD. Ms. Grooms, what are your thoughts on this? And again, regarding the $25,000 limit, what is the view of Bank of America?

Ms. GROOMS. Bank of America is supportive in a number of areas, including this one, of transparency and disclosure that is in the best interest of the consumer, in this case the student and perhaps their family. So I agree with Mr. Tarr, that should not be a problem.

But also emphasize that we are compliant with the Truth in Lending Act, and provide the consumer with a 10-day grace period upon receipt of the Truth in Lending statement, in which they can cancel the loan.

Chairman DODD. Mr. Goulding.

Mr. GOULDING. We already are complying with the Truth in Lending Act and all of our private education loan borrowers do receive a Truth in Lending Act disclosure today.

Chairman DODD. And the number, raising the number, you have no objection to that?

Mr. GOULDING. No. We are complying with it up and down the line.

Chairman DODD. But I am suggesting raising the limit.

Mr. GOULDING. No, we would not have a concern with that.

Chairman DODD. Let me come right back, if I can here. You stated that in calculating a student's private loan interest rate, one of Sallie Mae's considerations is the default rate of the individual institution of higher education. I wanted to ask Ms. Grooms and Mr. Tarr, do your companies use either default rates or graduation rates of an individual institution in determining what interest rate you offer a student that is applying to those schools or in those institutions?

Mr. TARR. No. What First Marblehead does is we are partners with a non-profit guarantor, the Educational Resources Institute, which has an approved list of 6,500 colleges and universities. The criteria they use to determine who is on that list include whether it is public or private, operating history, financial condition, accreditation by recognized national or regional agency, licensing by State authority, program course offerings, and Federal Title IV loan programs. Those are the criteria that are used to select the schools that we support.

Chairman DODD. Ms. Grooms.

Ms. GROOMS. And Senator, we rely on First Marblehead and the agency that he referred to for the underwriting. So his response is the same for Bank of America.

Chairman DODD. So the default rate of students at the institution is not a criteria in making a determination and that is the case in either case?

Ms. GROOMS. Yes.

Chairman DODD. And Mr. Goulding, why do you do that? Why does Sallie Mae do that? We heard Andrew Cuomo talk earlier and talk about the redlining aspects of all of this. Why does Sallie Mae insist on using that as a criteria when the students themselves ought to be the determination as to whether or not they are going to get the loan?

Mr. GOULDING. We have a number of criteria we look at. The primary criteria is certainly the credit score of the borrower if they have one, as well as the credit score of a coborrower if they have a coborrower.

Chairman DODD. I understand that.

Mr. GOULDING. And we do encourage coborrower.

Chairman DODD. But why do the institution ?

Mr. GOULDING. Well, we look at academic progress, as well, Senator. That is a key issue because we have found that the highest correlating event to a default is for a borrower who drops out and does not complete their education. And we also consider the competitive landscape. We look at the default rate of students or borrowers that we have, in our experience, have attended a particular institution because we think when you are not looking at income

and when you are not looking at debt-to-income ratios, and you are not requiring income or debt-to-income ratios, that the historic experience you have had with students attending a particular institution does have an impact on the long-term ability——

Chairman DODD. How does that differ from people in banks who decided not to lend money to someone because they lived in a certain neighborhood based on performance?

Mr. GOULDING. Let me be clear. This is not whether they are eligible for the loan or not. This would just be an impact potentially——

Chairman DODD. Well, it affects their ability to get the loan if they——

Mr. GOULDING. No, it does not. No, I am sorry, I misstated. It does not affect their ability to get the loan. It would affect potentially the rates and fees they would get.

Chairman DODD. Well, how should that be the case? If a person has got a good record and meets these other criteria based on them performing well, why would you brand someone because of the institution over the years, for whatever reasons? It could be that they have had, just given the economic circumstances over the history. Historically black colleges, to use an example, historically the kids are coming from families that do not do—have not done as well economically. Putting aside the reason why here for a minute here, that child then or that family is disadvantaged in terms of getting a loan because they come from an institution that over the years, because of economic circumstances, through no fault of the young person or their family, has a disadvantage on a rate.

So they are going to pay a higher rate, counter—actually going directly opposite of what we are trying to do, and that is to take disadvantaged students to provide greater assets for them so they can get that education. You are doing just the opposite. Why?

Mr. GOULDING. We actually looked, in preparing for today's hearing, we looked at six different historically black college and universities on our system. And we found that three of them are getting the very best rates that we have and three of them are getting the rates that are slightly less attractive.

So in that case it probably had more to do with the competitive landscape, whether or not those schools were actively seeking out information from lenders and creating a preferred lender list based on the best terms and conditions that those lenders had to offer.

Chairman DODD. But they are going to get a different product, and that is the bottom line.

Mr. GOULDING. No, it is the same product, it is just——

Chairman DODD. Well, it is a higher cost.

Mr. GOULDING [continuing]. Slightly different price.

Chairman DODD. No, higher price. Higher price, right? More costly.

Mr. GOULDING. Maybe 50 basis points or 100 basis points.

Chairman DODD. You are out there trying—let me tell you, looking at what these costs of college are, that may not seem like much to somebody but if you are struggling as a family, that 50 basis points can make the difference in some cases here.

And again, going back to the fairness of it, in many ways, doing exactly the opposite, it seems to me, is exactly the wrong direction we should be heading in on that.

Let me ask you about the bankruptcy stuff. I opposed the Bankruptcy Act. I thought it was a dreadful piece of legislation that came along, but obviously I did not prevail. I was in the minority on it.

But advocates suggest here that the standard views in the Bankruptcy Act, undue hardship, failing to maintain a minimum standard of living before being able to discharge their private student loans in Chapter 7. Advocates suggest that the standard makes it nearly impossible for borrowers to discharge private loans and argue that lenders do not need special bankruptcy protection because private loans are often secured by a cosigner and banks have no limits on fees and rates they can charge borrowers under Federal loans.

Do you think the Bankruptcy Law is appropriate or inappropriate? Mr. Tarr.

Mr. TARR. My personal view is it is appropriate.

Chairman DODD. You think it is appropriate?

Mr. TARR. Yes, and one reason I say that is I think that if there is a change to the bankruptcy code in this respect, it will have an impact on the availability of private student loans. And I think we should all be mindful of what we are trying to address, as you eloquently said in your first early remarks, a growing gap of the education going like this, available funds are like this.

If there is a change to the Bankruptcy Act, it could impact the amount of private student loans that are available to address that gap.

Chairman DODD. Are you serious about that answer?

Mr. TARR. Yes, I am. Yes, I am, sir.

Mr. SWARTHOUT. God, so many things to say, so many objections to that idea.

This is parallel—this conversation parallels the subprime mortgage argument. We have just seen huge default rates in the subprime mortgage industry. And the case is we need to be able to offer these incredibly predatory rates to borrowers, particularly low income borrowers, to be able to provide them with a loan for their house.

If we are setting students up with interest rates that they cannot repay, that a significant percentage of students will default on, we are not doing favors to students. We are not increasing access. We are not increasing affordability. And we are certainly not doing what students need in order to succeed in our country.

Mr. Goulding made a comment a little bit earlier where he described private loans are an investment in human capital. Well, if private loans are an investment in human capital for your company, then bankruptcy protections are the shackle that keeps that human capital from being able to escape. Because essentially we are taking 18-year-olds who are aspiring for a higher education and asking them to suffer penalties and bankruptcy laws that we provide to almost no other consumer credit.

We treat student loan defaulters in the private loan industry the same way we treat people who fail to pay alimony and fail to pay their taxes. That is an astounding idea.

Why, given the social value of student loans, would we treat students as the lowest class of borrowers, if we really expect to invest in America's future and our higher education? I strongly object to that concept.

Chairman DODD. Go ahead, Mr. Tarr.

Mr. TARR. May I respond?

Chairman DODD. Yes, certainly.

Mr. TARR. First of all, I do not believe I used the word predatory lending. I think we should go back in time and focus—we have all commented this morning on how rapidly this industry has developed. This industry has developed and grown rapidly because it is addressing a gap that previously was being addressed by credit cards or not at all.

So the alternative was, unfortunately, many students were not getting to school period. And students—I happen to be an advocate of informed choice. And students and their families, if provided with the right information, are in the better position, I believe, to make a decision whether to take on a market priced loan. If the family chooses not to, that may prevent someone from going to school.

And the alternative is credit cards. And I think we would all agree that credit cards are not preferable. Their rates are more expensive. And oh, by the way, they are not a—they are an instrument that has to paid off monthly. This is a 20-year unsecured obligation.

Chairman DODD. Let me just interrupt for a second. I hope we did not create this impression. We all understand there is a gap that has to be filled. Even if you increase, as we should, the Federal loan program here. I hope none of you argue over that point. This is ridiculous. It has been flat-lined for the last number of years, watching the costs increase dramatically.

I doubt it is ever going to close that gap. So you are going to be dealing with a gap. And so obviously there is a very important market here.

The question is how does that market work? And to what degree is there any kind of a regulatory scheme here and oversight, so that we are guaranteeing that the kind of things that Andrew Cuomo pointed out are not going to go on.

And you have all indicated that none of you engage in these practices that he talked about, the kickbacks and the financing or allowing people to serve on boards and so forth. I presume that is the case.

Is there anything in the criteria that have been laid out by the Department of Education or anything that Andrew Cuomo, as Attorney General of New York, have advocated that you disagree with?

Mr. TARR. No, the code of conduct that the New York Attorney General supported we support wholeheartedly. We are advocates of disclosure and transparency. So I do not believe there is requirement for additional regulation. But the provisions that were put forward by Attorney General Cuomo we are supportive of.

Chairman DODD. Ms. Grooms, you agree with that as well?

Ms. GROOMS. Absolutely. As my testimony indicated, we voluntarily accepted the college code of conduct. We are evaluating the proposed sunshine act which I believe has already passed the House. And that is pretty consistent with the code of conduct. There is some more specificity there and we want to make sure, should that become law, that we not only meet but hopefully exceed the expectations.

Chairman DODD. Beside from the point we just talked about a minute ago, Mr. Goulding, do you have any objections to the code of conduct principles that have been laid out?

Mr. GOULDING. No, we have also adopted the code of conduct and are supportive of those principles.

Chairman DODD. Let me go back. Mr. Avidan, I have not asked you any questions at this point here, but again, just from your own personal experience here, what is your reaction to what you are hearing here?

Mr. AVIDAN. I feel that there is a gap. I am personally affected by that large gap. But I do not think that that is the main issue. I think the main issue is keeping rates low and providing support and proper disclosures for the borrower up front and during the process of them paying back the loans.

I feel that once the loans are given they—they, being the lenders—they forget those people because they already got the promissory notes in their possession and they are signed and dated. So they move on to the next people that they can see how much of a rate they can get from them.

Chairman DODD. Let me, if I can, I want to ask two final questions, if I can. I want to raise again, with the lenders here, the Community Reinvestment Act issue here.

It strikes me that we should be promoting, of course, incentives for lenders to provide the neediest students with good loans. The loans, in my mind, that are similar in rate and fee structure to those under the Federal loan program.

I think you all have said you indicate you agree with that general notion. I presume that has been the case. So I wonder if your institutions, they receive Community Reinvestment Act credit for student loans that you make. Is that true, Ms. Grooms?

Ms. GROOMS. We do include our student loan information in our $750 billion commitment to low and moderate-income families and communities. I cannot affirm specifically that it is included in the official CRA data. That is something I would be happy to follow up on and respond back.

Chairman DODD. What I would like to know is what kinds of loans do you receive credit for? And do the bank regulators give you credit for giving any loan to any student, including loans with high interest rates? I mean, I would be interested in whether or not that is the case.

I do not think you are involved in this aspect at all, Mr. Goulding.

Do you have any comments on this, Mr. Tarr?

Mr. TARR. No, I do not.

Chairman DODD. OK. Well, I would like to check on that.

We will submit, by the way, I would ask staff to submit that same question to other major lenders here, so we get the answer to that question as to how that works, as well before us here.

Let me ask others here, as well. We have got this potential sale of Sallie Mae. And I am wondering what impact do you think that sale could have on competition and the products and services made available to student borrowers? Let me start with you, Mr. Swarthout.

Mr. SWARTHOUT. I think, just a quick preface, which is to say at a time when we are seeing a greater demand for oversight, a greater demand for transparency, it is interesting that the largest player in this market will become less transparent and—by becoming a—going from a publicly traded company to a private entity.

As far as products, I mean I think there are reasons for concern about the control of the market amongst a small number of players. We have seen this for a number of reasons and certainly will be continued concern as this process moves forward.

We should note that for a—not on private loans but on federally subsidized loans, for a market that has fantastic subsidies, we have very little price competition historically. I think that is also one of the things that Attorney General Cuomo has found in his investigation.

So there are reasons for inquiry.

Chairman DODD. Let me ask you, Ms. Pae, about this, because I want to ask Mr. Tarr and I want to ask you, Ms. Grooms. Then I want to give you a chance, Mr. Goulding, to respond to what you have heard as well, in fairness to you here. Ms. Pae?

Ms. PAE. Just to let you know that the U.S. Student Association has actually partnered with SEIU, Service Employees International Union, in regards to this issue. So they have some very good materials around why this is a large concern for not only the larger industry but specifically for how this plays out for students.

As far as the profits that are at the expense of students, I think this plays a larger role in what type of competition is really, truly available for students and what type of real deals will students get in the private loan industry. So although I am not well versed on the issue, per se, I think it would be a good point of reference for the Committee to look at these materials.

Chairman DODD. Mr. Tarr, do you want to comment on this?

Mr. TARR. Senator, given that our two largest clients are involved, I would prefer not to.

Chairman DODD. I thought I might slip that one by you here.

[Laughter.]

In a moment of weakness.

Mr. TARR. I appreciate your understanding, Senator.

Chairman DODD. You are taking the Fifth on this one.

Ms. Grooms.

Ms. GROOMS. Mr. Chairman, as we have stated, the Bank of America student lending business remains separate. It will compete separately from Sallie Mae. We continue to serve our customers and compete each day. And that aspect has not changed.

Chairman DODD. Mr. Goulding, do you want to comment on this at all? This is not normally a question you would raise, but obvi-

ously it is on everyone's mind and is out there in the proposal. Do you want to share any thoughts or comments on this?

Mr. GOULDING. Yes, Senator. First, let me caveat it by saying I am being acquired. I am not the acquirer. So I am speaking to this from a Sallie Mae perspective. And I have not been intimately involved with the transaction that you are referring to.

Sallie Mae certainly has, in our history, conducted ourselves with transparency. We plan to continue to do that, public or private. And our buyers did put out a press release with respect to this issue in May. The statements they made were that as a private company Sallie Mae would continue to comply with the student loan code of conduct, it would continue to be regulated by the Department of Education and the FDIC, that we be continued to be subject to Congressional oversight, that we would be subject to all Federal and State laws including the Higher Education Act, that we would continue to participate in the public debt markets and issue relevant filings on our performance and financial health with the SEC, and that we would apply with all applicable Sarbanes-Oxley requirements.

So on the transparency side, I think that the buyers have addressed that.

On the competitive front, as Ms. Grooms stated, Bank of America plans on continuing to vigorously compete with both Sallie Mae and the other minority bank investor. I should remind all that the banks involved with this transaction are minority investors, and that Sallie Mae has competed with both these banks historically. We are competing with them now. We would envision continuing to compete with them in the future.

And I would disagree with the statement made by the gentleman to my left. I think there is active competition in this market. There are new entrants entering this market as we speak, and some very formidable consumer finance companies have entered this market space.

Chairman DODD. Mr. Bell, do you want to comment on this at all, as a student financial aid officer?

Mr. BELL. No, Senator. I really do not have any comment on it.

Chairman DODD. I wanted to give you a chance to do that.

Listen, there are a lot more questions people I know are going to want to raise here about all of this. But this is a very important issue. Again, there is a lot of interest in the subject matter, as I know all of you know.

Again, I want to make it clear here, look, and there is going to be a lot more legislative action probably on higher education generally. But again, I want to state the case here, there is clearly a need here for private loans. There is no question about that, particularly in light of the gap that exists. So we are not—I do not want anyone to leave here with the assumption somehow there is hostile feelings about the product. The question is how the product is being handled and managed, and to what extent it is being managed in such a way as to disadvantage students and their families, with many of the items that have been raised by the Attorney General of New York and others, that those practices have to stop.

I am going to inquire as to the—I am going to have a meeting with the—with Senator Shelby obviously involved in all of this—

with the Federal regulators to find out what they are doing, why they have not been. We listened to Andrew Cuomo talk about this being the wild west. And of course, the obvious question one wants to ask is where was the sheriff here? A lot of these things were going on for some time.

We have talked about the subprime lending problem. That was going on for some time. We know there were people aware of this issue years ago and did nothing from a Federal agency perspective where they had jurisdiction, in my view. And I am not going to wait around for this problem to grow or become a greater concern, but to step in and to find out what, if anything, the regulators are doing. And if they need additional legislation, we will move on that. If there is additional regulatory authority, I want to find out what they need to get that, so that we have an aggressive cop here watching all of this. So the practices we have heard about are going to stop on this one way or the other.

So again, I thank all of you for being here. We will keep the record open for additional questions. But I am very grateful to all of you.

I want to thank the lenders who are here for being here.

Ms. GROOMS. Thank you, Mr. Chairman.

Chairman DODD. I realize you are stepping up here.

Mr. TARR. Thank you.

Chairman DODD. There is a lot of other people who engage in this business who are not here, but we are very much aware of some of the activities that are going on.

So I think you for coming. This Committee will stand adjourned.

[Whereupon, at 1:19 p.m., the hearing was adjourned.]

[Prepared statements supplied for the record follow:]

## PREPARED STATEMENT OF SENATOR ROBERT P. CASEY

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

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

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

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

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

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

- The first is the breach of trust between schools and students. There is an important relationship there that some schools, though certainly not all, have been far too cavalier with.
- The second is deceptive and in some cases predatory and abusive practices on the parts of lenders.
- The third is the way that some of these lending practices undermine federal student aid policies, which are designed to make college affordable and accessible to all students.

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

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

**STATE OF NEW YORK ATTORNEY GENERAL**

**ANDREW M. CUOMO**

**TESTIMONY**

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

**Washington, D.C.**
**June 6, 2007**

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

**I. Background**

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

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

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

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

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

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

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

## II. Problems Uncovered

### A. Revenue Sharing

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

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

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

**B. Preferred Lender Lists**

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

**C. Improper Relationships Between Lenders and School Administrators**

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

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

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

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

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

**D. Quid Pro Quo "Opportunity Loans"**

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

**III. Solutions**

**A. Code of Conduct**

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

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

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

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

**B. State Legislation**

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

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

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

**C. National Action**

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

**D. Congressional Action Needed**

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

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

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

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

**IV. Conclusion**

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

**Statement of Jonathan Avidan**

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

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

**June 6, 2007**
**10:00 am**

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

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

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

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

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

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

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

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

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

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

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

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

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# United States Student Association

Testimony of Jennifer Pae
President, United States Student Association

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

United States Student Association
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(202) 637-3924 www.usstudents.org

# The First Marblehead Corporation

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

The First Marblehead Corporation
Opening Statement

Washington, DC
June 6, 2007

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

As a result:

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

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

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

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

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

**Prepared Statement of**

**Barry W. Goulding**
**Senior Vice President,**
**Sallie Mae**

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

**United States Senate**
**Committee on Banking, Housing and Urban Affairs**

**538 Dirksen Senate Office Building**
**Washington, D.C.**

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

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

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

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

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

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

**About Sallie Mae**

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

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

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

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

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

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

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

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

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

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

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

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

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

**How Families Pay for College**

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

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

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

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

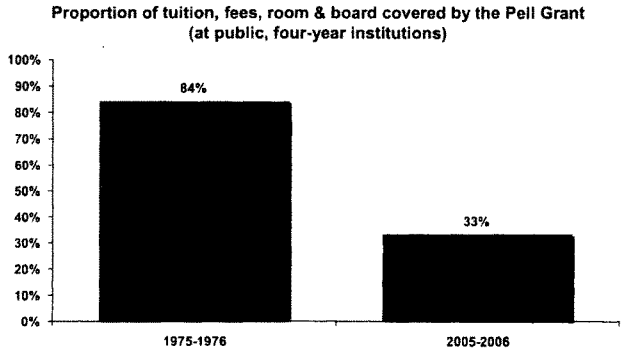
Students are also working more during the academic year. Today, 78% of students work during the academic year. And those students who work are working more hours than ever before. Students also rely on credit cards. Today, more than half of dependent undergraduates have credit cards and carry a median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

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

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

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

**Declining Purchase Power of the Pell Grant**



**Federal Student Loans**

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

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

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

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

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

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

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

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

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

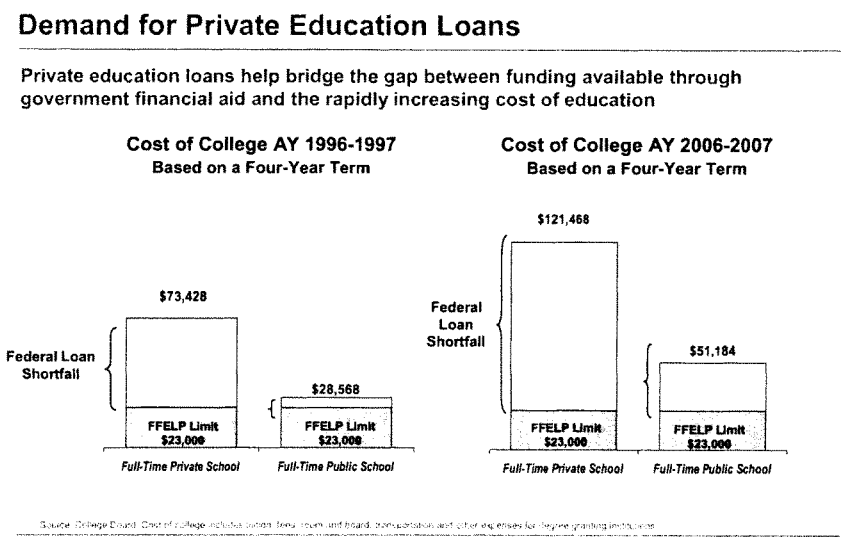
We applaud legislative proposals designed to encourage students to determine their eligibility to apply for low-cost federal student loans before seeking more costly private loans. Indeed, as described below, given the growing importance of private loans to many families, we believe that it is imperative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

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

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

**Private Student Loans and How the Loan Process Works**

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




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

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

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

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

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

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

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

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

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

**Regulation of Private Education Loans**

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

**Obtaining a Student Loan From Sallie Mae**

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

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

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

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

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

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

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

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

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

**Student Loan Marketing Practices**

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

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

**Conclusion**

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

# # #

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

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

**Howard University's Relationship with Private Educational Loan Lenders**

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

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

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

*Prepared by: Sevester Bell, Howard University, Office of Student Financial Services*

**Table 1**
**Total Loans Disbursed by Program**

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

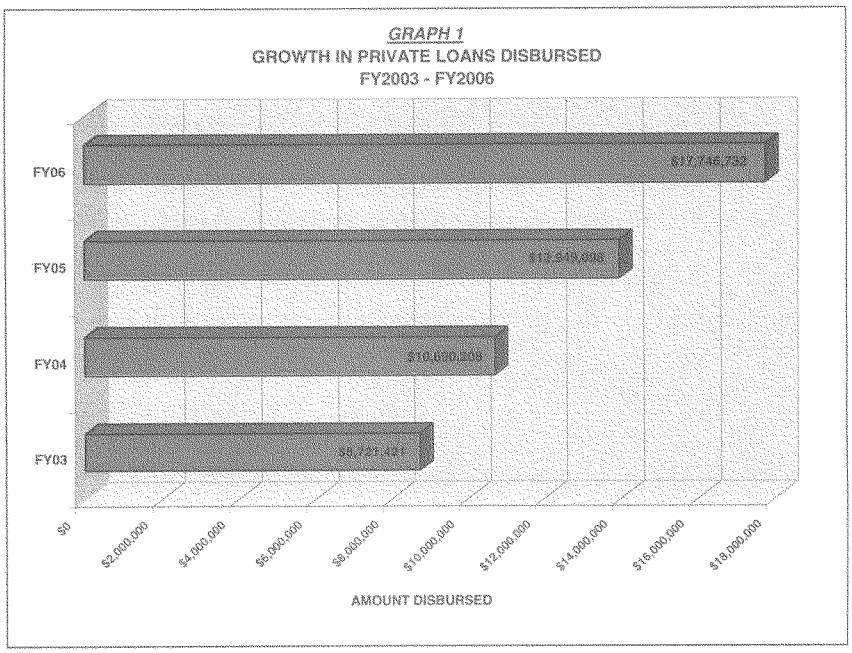
**Howard University's Compliance with Federal Student Aid Regulations**

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

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

**The Growth and Development of the Private Educational Loan Market**

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



**Private Educational Loan Lenders' Role in Student College Accessibility**

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

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

**Student Borrowers Impacted by Private Educational Loan Lender Practices**

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

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

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

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

**Implications of Private Educational Lending**

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

Testimony of

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

## Recommendations

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

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

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

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

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

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

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[i] Project on Student Debt, *High Hopes, Big Debt.* http://projectonstudentdebt.org/files/pub/High_Hopes_Big_Debts.pdf, accessed on June 4th, 2007.
[ii] Project on Student Debt, *Quick Facts About Student Debt.* http://projectonstudentdebt.org/files/File/Debt_Facts_and_Sources_5_4_07.pdf, accessed on June 4th, 2007.
[iii] College Board, *Trends in Student Aid 2006*, http://www.collegeboard.com/prod_downloads/press/cost06/trends_aid_06.pdf
[iv] Institute for Higher Education Policy, *The Future of Private Loans: Who is Borrowing and Why?* December, 2006. http://www.ihep.org/Pubs/PDF/FutureofPrivateLoans.pdf accessed on June 4th, 2007.
[v] Kate Rube, *Private Loans: Who's Borrowing and Why?*, State PIRGs Higher Education Project, 2003.