Expanding Opportunities and Resources for Students by Promoting the Availability of Private Student Loans

Over the last 10 years, the private student loan market has undergone dramatic changes. Up until 2008, private student loan volume grew rapidly as college tuition prices increased, more private sector lenders entered the market, and some relaxed their underwriting criteria. These trends ended with the financial crisis when a number of borrowers experienced difficulties in repaying their loans, resulting in increasing default rates. Many lenders also ran into problems financing their private student loan portfolios because of the weak credit markets. Public and not-for-profit lenders experienced similar issues, although to a lesser extent. Since 2008, private student loan volume has dropped, underwriting has tightened, the use of co-signers and school certification has become almost universal, and defaults have declined significantly, down to levels that are significantly lower than those of federal student loans.

Private loans and private capital continue to play an important role in financing postsecondary education. The following facts should be considered in support of this source of funding:

- Given escalating college costs and the loan limits on Stafford Loans, private student loans provide an important source of funding that enables many students, particularly undergraduate students, to attend the college of their choice.

- Private student loans are credit-based, have lower default and delinquency rates than federal student loans, and are not funded with federal debt, in contrast to those loans made under the Federal Direct Loan Program.

- For credit-worthy parents and graduate and professional students, private loans may carry more attractive rates and terms than federal student loans, thus reducing total borrowing costs to a postsecondary education.

- The private student loan industry is highly-regulated, especially with the added oversight of the Consumer Financial Protection Bureau (CFPB). This oversight, together with the discipline of the capital markets, protects borrowers and leads to improved customer service, better loan counseling, innovation, and lower-cost loans.

According to the College Board, nonfederal education loans grew from an estimated $13.7 billion in 2003-04 to $26 billion in 2007-08, but declined to $10 billion in 2014-15. Following the end of originations under the Federal Family Education Loan Program (FFELP), the vast majority of student loans are now made under the Federal Direct Loan program, where annual lending totaled almost $95 billion in 2014-15. The Direct Loan portfolio now stands at $840.7 billion, and is expected to continue to grow at a substantial rate. The U.S. Treasury Department is increasingly concerned over the demands involved in financing this sizable loan portfolio.

One of the contributing factors to the higher default rate on private student loans made 10 years ago was that many of the loans were made directly to the consumer without the involvement of the school's financial aid office. In some cases, this meant that the lender did not know how much the institution was charging the student or how much grant and/or loan aid the student was receiving, potentially leading to over-borrowing. Today, almost all private loans are school certified. Financial aid officers can – and should – have a role in assisting their students, a practice facilitated by the financial aid office's certification of an application for a private loan.

Recently, the U.S. Department of Education announced the three-year cohort default rate on federal student loans that entered repayment in FY 2012 was 11.8 percent. Severe delinquencies (more than 90 days delinquent) rose to 11.45 percent in the second quarter of fiscal year 2015 according to the Federal Reserve Bank of New York. In contrast, according to a report released by MeasureOne, early and late stage delinquency rates in the private loan market averaged 2.8 percent and 2.2 percent respectively, and the annualized charge-off (default) rate experienced by the six largest private loan lenders and holders stood at 2.2 percent for the third quarter of calendar year 2015. The data clearly shows that private student loan lenders have adopted prudent lending policies and that, on the whole and diverging with the situation in Direct Lending, private student loan borrowers are largely able to handle their repayment obligations.

A popular misconception is that all private student loans are more expensive than federal student loans and interest rates on outstanding loans will rise over time. For some borrowers, however, private student loans offer an attractive alternative to federal student loans, particularly when compared to Grad and Parent PLUS Loans. PLUS Loans made this year carry an interest rate of 6.84 percent, with an origination fee of almost 4.3 percent. A decade ago, most private student loans had variable interest rates that rose and fell with short term-market rates. Today, many private lenders offer fixed rate loans to qualified borrowers with interest rates that are lower than the rate for PLUS Loans, and without an origination fee. Media stories claiming that the interest rates on private student loans are in the "teens" do <u>not</u> accurately portray the majority of rates offered today to creditworthy borrowers. In fact, private lenders uniformly counsel applicants to look first to the terms available on Direct Loans before taking out private student loans. The appropriate role for the federal government is to help low-income borrowers access federal student loans, while allowing the private sector to serve creditworthy borrowers. This is especially true when the private sector can offer competitive or better terms.

NCHER Reform Proposals

The National Council of Higher Education Resources (NCHER) believes that private student loans play an important role in higher education finance. We urge Congress to ensure qualified borrowers have access to more attractive loans and reduce unnecessary demands on U.S. Treasury financing by:

- <u>Removing preferred lender list restrictions.</u> Under the Higher Education Opportunity Act (HEOA) enacted in 2008, colleges and universities choosing to maintain a list of preferred lenders for private education loans must comply with a set of complicated disclosures and reporting requirements. The result has been that many schools have shied away from having preferred lender lists and largely ended counseling students and parents on various sources of financial aid, including private loans. The Task Force on Federal Regulation of Higher Education, a bipartisan effort to identify the most burdensome federal regulations with significant costs and questionable benefits to students and institutions, noted that the preferred lender list rules "are overly prescriptive and create barriers to providing information about non-Title IV loan programs with favorable terms for students." Given other HEOA reforms (such as gifting prohibitions), the preferred lender list restrictions are causing unintended and unnecessary costly outcomes for many borrowers and should be repealed during the upcoming reauthorization of the Higher Education Act (HEA). At a minimum, there should be an exemption for private education loan programs that offer rates and fees that are comparable to or better than those offered in the PLUS program. In these instances in particular, current law could well result in students and parents not learning about loan programs that might be better for them financially.

- Mandating that Direct Loan borrowers receive accurate disclosure of the cost of their loans. The Truth-in-Lending Act (TILA) ensures that applicants for almost all consumer loans are provided with a federally-mandated disclosure of the true cost of the loan (the annual percentage rate or APR), including the interest rate, any origination fees, and all other loan costs. The purpose of the notice is to allow borrowers to compare different loan options before they become financially obligated. Private loan borrowers receive the disclosure. Loans made under Title IV of the HEA, however, are exempt from this requirement. As noted above, for some borrowers, particularly parents and graduate students who might be looking at PLUS Loans, private loans may be a better, less costly choice. Congress should, at a minimum, ensure that Direct Loan applicants receive the same cost transparency disclosure as private student loan borrowers upon approval of their loan application pursuant to section 226.47(b) of Regulation Z. This disclosure is provided prior to the borrower becoming obligated on the loan and will allow the applicant to fairly compare the terms of different borrowing options.

- Permitting private lenders to remove the default record upon the rehabilitation of a private education loan. Under the federal student loan program, defaulted borrowers who make nine voluntary, on-time payments over a 10-month period can have their student loans rehabilitated, and the default status removed from their credit reports. This provides a powerful incentive for borrowers to undertake what is needed to rehabilitate their student loans. Even though the CFPB strongly recommends that private lenders help distressed borrowers, private lenders are prevented from utilizing this tool. Congress should amend the Fair Credit Reporting Act (FCRA) to allow private lenders to remove the default record when the borrower satisfies the lender's rehabilitation standards. This change will help many struggling borrowers avoid the ongoing stigma of default.

- Considering capping the amount parents can borrow under the PLUS Program. Parents today can borrow the full cost of college for all of their dependent children, including amounts for living expenses, under the Parent PLUS program. While some can afford to take out excessive student debt, many parents become saddled with debt for which they have no ability to repay. This is why numerous concerns were raised over parent borrowing when the Department of Education's negotiated rulemaking committee discussed revising the credit criteria for the PLUS program last year. During the upcoming HEA reauthorization process, Congress should consider limiting the amounts that parents can borrow under the PLUS program. By doing so, federal policymakers would remove the incentive for those with lower credit scores – those more likely to struggle with their repayment burden – to take out student loans that they can ill afford.

If you have questions or need more information, contact Sean Deverey, Vice President for Government Relations at the National Council of Higher Education Resources (NCHER), at sdeverey@ncher.us or (202) 822-2106.